

Taxing Human Capital Acquisition Costs—Or Why Costs of Higher Education Should Not Be Deducted or Amortized

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I. INTRODUCTION

Several recent articles have argued for the capitalization and amortization, under the federal income tax, of outlays for higher education,¹ and other

¹ See Loretta C. Argrett, *Tax Treatment of Higher Education Expenditures: An Unfair Investment Disincentive*, 41 SYRACUSE L. REV. 621 (1990); David S. Davenport, *Education and Human Capital: Pursuing an Ideal Income Tax and a Sensible Tax Policy*, 42 CASE W. RES. L. REV. 793 (1992) [hereinafter Davenport I]; David S. Davenport, *The 'Proper' Taxation of Human Capital*, 52 TAX NOTES 1401 (1991) [hereinafter Davenport II]; Brian Lebowitz, *On the Mistaxation of Investment in Human Capital*, 52 TAX NOTES 825 (1991); Christopher R.J. Pace, *The Problem of High-Cost Education and the Potential Cure in Federal Tax Policy: "One Riot, One Ranger,"* 20 J.L. & EDUC. 1 (1991); Clifford Gross, Comment, *Tax Treatment of Education Expenses: Perspectives from Normative Theory*, 55 U. CHI. L. REV. 916 (1988). Because education is available free of charge up through the twelfth grade, the amortization issue will be deemed to pertain only to college, graduate and professional school, and postsecondary vocational education. Amortization of precollege private school outlays will not be discussed here because, if the case cannot be made for amortization of college expenses, that for amortization of precollege expenses collapses a fortiori, given that early schooling expenses are considered to be less income related than later schooling expenses. Moreover, if we assume that the commitment to free education

authors have reached the same conclusion.² This Article argues the contrary position.

The amortization issue will be approached from the point of view of the "tax policy" norms of neutrality,³ (horizontal) equity,⁴ and the Haig-Simons definition of "income" as being the net increases in wealth plus the personal consumption of the taxpayer during the taxable period.⁵ The case for amortization fails to pass muster. It is better that the income tax system simply ignore human capital—as is presently the case—than attempt to account for it in a highly selective manner. I shall also deal with certain other tax issues relating to human capital, such as amortization of professional licences and deduction of continuing education, job seeking, and moving expenses.⁶

This Article also provides a critique of the dominant mode of legal tax policy scholarship, which relies excessively on the Haig-Simons definition of income. I argue that the Haig-Simons concept is itself "derived" from the more fundamental policy criteria of neutrality and ability-to-pay fairness, but these criteria themselves are problematical in various ways, including being partially inconsistent with each other.

A third theme of this Article is that the Haig-Simons income concept is susceptible to being both misconceived and misapplied in its "personal consumption" component. Personal consumption, which is "taxed" by disallowing any deduction for it,⁷ is conventionally identified by its alleged characteristic of yielding personal pleasure or utility. In my view, it is more

through twelfth grade is to be maintained, the real policy decision involves the possible subsidization of private education (through vouchers), not federal tax write-offs.

² See RICHARD GOODE, *THE INDIVIDUAL INCOME TAX* 80-87 (1976) (stating education is intended to meet minimum requirements for obtaining employment); Richard Goode, *Educational Expenditures and the Income Tax*, in *ECONOMICS OF HIGHER EDUCATION* 281 (Selma Mushkin ed., 1962); Daniel I. Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859, 903-05 (1974); Bernard Wolfman, *The Cost of Education and the Federal Income Tax*, in *PROCEEDINGS OF THE 29TH ANNUAL JUDICIAL CONFERENCE THIRD JUDICIAL CIRCUIT*, reprinted in 42 F.R.D. 437, 535-51 (1966). See generally John K. McNulty, *Tax Policy and Tuition Credit Legislation: Federal Income Tax Allowances for Personal Costs of Higher Education*, 61 CAL. L. REV. 1 (1973).

³ Briefly, "neutrality" posits that highly elastic investments should be taxed alike in order to promote allocative efficiency, which refers to an economy that produces the "right" quantity of various goods and services at the "right" prices, thereby maximizing aggregate social welfare.

⁴ Briefly, "(horizontal) equity" means that taxpayers in the same economic position should be taxed alike.

⁵ See HENRY C. SIMONS, *PERSONAL INCOME TAXATION* 50 (1938).

⁶ See *infra* text accompanying notes 171-93.

⁷ See I.R.C. § 165(c) (1988), amended by 107 Stat. 312, 485-86 (1993); I.R.C. § 167(a) (Supp. III 1991), amended by 107 Stat. 312, 466-67 (1993); I.R.C. § 262 (1988).

properly linked to the “neutrality” idea that accretions to wealth should only be taxed once. Thus, consumption should be deducted (only) where it is a “cause” of future income. But because the causal nexus is often loose, the issue of whether certain categories of consumption should be deducted is an open one that cannot be resolved by a priori reasoning.

The infirmity of the Haig-Simons income concept necessitates analysis of income tax policy issues on their merits, that is, in terms of fairness, economics, and other possible norms. Thus, one cannot avoid asking whether amortizing higher education costs would be a good thing.⁸ At this level, the issue cannot be resolved by vague appeals to international economic competitiveness and an assumed need for more higher (or vocational) education for more people. Furthermore, even if current levels of higher education were insufficient, it would not follow that a tax benefit in the form of amortization of education costs would be sound policy. Finally—and with implications beyond tax policy—it appears that current levels of higher education are sufficient, and that priorities for federal government aid to education lie elsewhere.

II. APPLYING TAX POLICY CRITERIA

This Part applies the criteria of neutrality, horizontal equity, substantive fairness (ability-to-pay), and Haig-Simons income to educational outlays in particular and human capital in general.

A. *Neutrality*

The neutrality argument for amortization of educational outlays is that investment in human capital should compete within the tax system on a “level playing field” with investments in conventional assets. Otherwise, scarce resources will be misallocated in the economy, that is, the tax system will breed economic inefficiency, in this case producing aggregate underinvestment in human capital.

The neutrality justification for amortization must show that: (1) a viable market in education exists, (2) investment in education is disfavored, (3) there is high elasticity between educational investment and conventional investment, and (4) amortization would in fact improve neutrality. None of these points withstands scrutiny.

⁸ Cf. Louis Kaplow, *The Income Tax As Insurance: The Casualty Loss and Medical Expense Deductions and the Exclusion of Medical Insurance Premiums*, 79 CAL. L. REV. 1485, 1486–87 (1991).

1. Viability of Education Market

Application of the neutrality criterion to investment in higher education presupposes, among other things, that investment in education occurs in a relatively free market. The existence of such a market might be “proven” in at least two ways. First, there would appear to be a free market in higher education if the private cost thereof equals the present value of incremental future earnings attributable to the education, using a discount rate equal to the prevailing return on relatively low-risk conventional investments.⁹ Second, one could directly inquire into the structure of the market in higher education.

a. The Human Capital Hypothesis

Some studies from the late 1950s and early 1960s—originating from the “Chicago school” of neo-classical economics—showed that the private (as opposed to social) rate of return on college education was close to, or even in excess of, the rate of return on conventional investments.¹⁰ This correlation is circumstantial evidence that potential students actually approach investments in

⁹ Investment in human capital, unless highly specialized, would not seem to involve any higher risk than equity investments generally. The freedom to not use one’s educational investment does not increase the riskiness of it, because such nonuse would be self-inflicted. *But cf.* David S. Davenport, *Depreciation Methods and the Importance of Expectations: Implications for Human Capital*, 54 TAX NOTES 1399, 1400–02 (1992) (asserting that investing in higher education is analogous, risk-wise, to transactions involving royalties for intangibles and mineral property).

¹⁰ GARY S. BECKER, HUMAN CAPITAL 198–200 (2d ed. 1975); Mark Blaug, *The Rate of Return on Investment in Education in Great Britain*, MANCHESTER SCH. 205–51 (Sept. 1965), reprinted in MARK BLAUG, THE ECONOMICS OF EDUCATION AND THE EDUCATION OF AN ECONOMIST, at 7 (1987) [hereinafter EDUCATION OF AN ECONOMIST]; Gary S. Becker, *Underinvestment in College Education?*, 50 AM. ECON. REV. 346, 347–49 (1960); W. Lee Hansen, *Total and Private Rates of Return to Investments in Schooling*, 71 J. POL. ECON. 128 (1963); Theodore W. Schultz, *Investment in Human Capital*, 51 AM. ECON. REV. 1 (1961) (Schultz and Becker have been professors at the University of Chicago.). These studies focus mainly on the private rate of return obtained by comparing net future incremental wages with net private costs. *But see* Gordon K. Douglass, *Economic Returns on Investments in Higher Education*, in HOWARD R. BOWEN ET AL., INVESTMENT IN LEARNING 359, 374–75 (1977) (noting the private return on education dropped below that of conventional assets in the early 1970s). There is also a “social” rate of return, obtained by weighing social benefits (including incremental tax yields, but not increased net wages) against governmental outlays, which is much harder to measure. The social return is said to be less than the private return, although it is still quite high. *See* M. Woodhall, *Human Capital Concepts*, in ECONOMICS OF EDUCATION: RESEARCH AND STUDIES 21, 22 (George Psacharopoulos ed., 1987) [hereinafter ECONOMICS OF EDUCATION].

(higher) education as rational investors.¹¹ This notion is commonly referred to as the "human capital hypothesis."

The human capital hypothesis has been subject to criticism and qualification.¹² The basic analytical problem is that the correlation between incremental education and incremental earnings does not establish that the education was the *cause* of the incremental earnings.¹³ The term "causation" denotes several kinds of relationships. There are "sufficient" causes, "necessary" causes, "but for" causes, and so on. Education cannot be a sufficient cause of significant incremental earnings, because any job must be actually practiced to produce wages. Nor would higher education be a necessary cause of higher wages in any logical sense, because many persons are able to obtain high earnings without higher education. Even granting that higher wages are statistically associated with higher education, one should look to what "causes" individuals to obtain higher education in the first place. Because the opportunity to obtain higher education, especially beyond college, is highly competitive, intellectual ability must be one factor.¹⁴ Another would be an environment (family background and resources) that allowed the individual to forego current wages in order to obtain higher education.¹⁵ A third would be personal traits (other than intellectual ability), including

¹¹ See, e.g., RICHARD B. FREEMAN, *THE MARKET FOR COLLEGE-TRAINED MANPOWER: A STUDY IN THE ECONOMICS OF CAREER CHOICE 1-15* (1971) (focusing on engineers and scientists).

¹² See Anita Manning, *College Has Little Effect on Income*, USA TODAY, July 13, 1992, at D1 (citing a Pennsylvania State University study showing that college and vocational education yield a rate of return of only 6% and 5% respectively). See generally ALAN J. DEYOUNG, *ECONOMICS AND AMERICAN EDUCATION* 127-34 (1989); Mark Blaug, Book Review, 24 J. HUM. RESOURCES 331 (1989) (reviewing *ECONOMICS OF EDUCATION*, *supra* note 10).

¹³ See generally M. Woodhall, *Earnings and Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 209, 212-14 (stating education is the leading indicator of earnings).

¹⁴ See Jere R. Behrman & Paul Taubman, *Is Schooling "Mostly in the Genes"?* *Nature-Nurture Decomposition Using Data on Relatives*, 97 J. POL. ECON. 1425 (1989); see also I. Fägerlind, *Ability: Effects on Earnings*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 285. But cf. Zvi Griliches & William M. Mason, *Education, Income, and Ability*, 80 J. POL. ECON. S74 (1972) (downplaying role of IQ in determining income).

¹⁵ CHRISTOPHER JENCKS ET AL., *WHO GETS AHEAD?* 81 (1979); Harvey Galper & Robert M. Dunn, Jr., *A Short-Run Demand Function for Higher Education in the United States*, 77 J. POL. ECON. 765, 767 (1969); cf. Mary Corcoran & Linda P. Datcher, *Intergenerational Status Transmission and the Process of Individual Attainment*, in *FIVE THOUSAND AMERICAN FAMILIES—PATTERNS OF ECONOMIC PROGRESS*, 169-206 (Martha S. Hill et al. eds., 1981) (stating that family background correlates more with schooling and occupational status than future income, but ability is less correlated with income).

appearance,¹⁶ that motivate a person to take advantage of higher education opportunities and help one to "succeed" in endeavors generally.¹⁷ A fourth would be plain luck.¹⁸ But native ability, environment, personality, and luck might produce higher earnings even without a higher education experience.

Statistical studies done by adherents of the human capital hypothesis purporting to show that these other factors account for significantly less of the incremental wage stream than does education¹⁹ are not completely convincing. Methodologically, statistical studies are incapable of showing what a person's earnings would be in the absence of the last marginal educational attainment. Empirically, the studies fail to account for the fact that persons within several guild-monopoly-like professions, such as law, receive widely variable salaries at any age level.²⁰ What the human capital hypothesis ultimately lacks is an explanatory hypothesis, other than free-market dogma, that would illuminate the statistical correlation.

To fill this theoretical lacuna, later commentators developed the "screening" (or "credentialist") theory of the relation between education and earnings.²¹ This theory holds that employers favor educated workers not so much for any specific knowledge or training acquired through the educational program as such, but because successful completion of an educational program is deemed by employers to be sufficient evidence of the requisite personality traits, such as trainability, communications skills, versatility, ability to defer gratification, ambition, time management skills, leadership ability, and social skills.²² Conversely, failure to complete degree programs is indicative of

¹⁶ Cf. Irene M. Frieze et al., *Perceived and Actual Discrimination in the Salaries of Male and Female Managers*, 20 J. APPLIED SOC. PSYCHOL. 46, 47 (1990) (stating that the physical attractiveness of a job candidate influences whether he or she will get the job).

¹⁷ JENCKS, *supra* note 15, at 230, 306.

¹⁸ CHRISTOPHER JENCKS ET AL., *INEQUALITY: A REASSESSMENT OF THE EFFECT OF FAMILY AND SCHOOLING IN AMERICA* 227 (1972).

¹⁹ See, e.g., Woodhall, *supra* note 13, at 209, 212. The methodology used in arriving at such a coefficient is attacked in Steven J. Klees, *Planning and Policy Analysis in Education: What Can Economics Tell Us?*, 30 COMP. EDUC. REV. 574, 581-83 (1986).

²⁰ See *infra* note 30.

²¹ The first five chapters of *EDUCATION OF AN ECONOMIST*, *supra* note 10, at 3-140, reveal Psacharopoulos's progressive conversion to the screening theory.

²² See Kenneth J. Arrow, *Higher Education as a Filter*, 2 J. PUB. ECON. 193 (1973); Joseph E. Stiglitz, *The Theory of "Screening," Education, and the Distribution of Income*, 65 AM. ECON. REV. 283, 292-95 (1975); Lester C. Thurow, *Measuring the Economic Benefits of Education*, in *HIGHER EDUCATION AND THE LABOR MARKET* 373 (Margaret S. Gordon ed., 1974). See generally Mark Blaug, *The Empirical Status of Human Capital Theory: A Slightly Jaundiced Survey*, J. ECON. LITERATURE, Sept. 1976, at 827, reprinted in *EDUCATION OF AN ECONOMIST*, *supra* note 10, at 100.

negative traits.²³ An empirical confirmation of the "credential" hypothesis is the fact that the rate of return is significantly higher for the twelfth grade of high school and for the senior year of college than for the immediately preceding grades.²⁴

A sociological version of the screening theory asserts that the principal function of higher education is to maintain an elite that appears to be open to all on the basis of intellectual merit but in the main serves to perpetuate existing class hierarchies.²⁵

The screening theory somewhat finesses the causation problem inherent in the human capital hypothesis: It is not necessary to inquire whether the requisite traits that produce higher wages are "caused" by the higher education or are simply revealed, or "filtered," through it.²⁶ On the other hand, the screening theory suggests the presence of an additional major "cause" of incremental human capital, namely, specific job placement and on-the-job training and socialization. In other words, educational attainment is just a "preliminary" screening device. Because desirable personality traits might exist independently of higher education, the screening theory has the virtue of implicitly challenging employer personnel policies that overvalue educational credentials. The screening theory also poses a challenge to the mission and social value of higher education.²⁷ In other words, it cannot simply be assumed, uncritically, that more and more higher education is desirable. This point is developed in Part III.

²³ Michael R. Olneck & Ki-Seok Kim, *High School Completion and Men's Incomes: An Apparent Anomaly*, 62 SOC. OF EDUC. 193, 194 (1989). This thesis is borne out by the fact that successful takers of the GED (high school equivalency exam) generally do not fare as well in the job market as do those with high school diplomas. Although cognitive knowledge and skills are about equal in the two groups, the GED option could be taken to signal high risk as indicated by earlier failure, inability to function in a group of peers, and lack of self-discipline, and similar shortcomings. See Iver Peterson, *As More Earn Equivalency Diploma, Its Value Is Debated*, N.Y. TIMES, Oct. 21, 1992, at B10.

²⁴ See Hansen, *supra* note 10, at 134. But see THOMAS J. KANE & CECILIA E. ROUSE, LABOR MARKET RETURNS TWO- AND FOUR-YEAR COLLEGES: IS A CREDIT A CREDIT AND DO DEGREES MATTER? (National Bureau of Economic Research Working Paper No. 4268, 1993). Also, a subcategory of credential, good grades in college, is significantly correlated with higher earnings. Estelle James et al., *College Quality and Future Earnings: Where Should You Send Your Child to College?*, 79 AM. ECON. REV. 247, 251 (1989).

²⁵ See generally THE SOCIOLOGY OF EDUCATIONAL EXPANSION (Margaret S. Archer ed., 1982). However, going to an elite private Eastern college, although positively correlated with earnings, is a relatively weak indicator thereof compared to grades and major. James et al., *supra* note 24, at 250-52. Of course, earnings itself is but one indicator of elite status.

²⁶ See D.R. Winkler, *Screening Models and Education*, in ECONOMICS OF EDUCATION, *supra* note 10, at 287.

²⁷ See *infra* text accompanying notes 242-45.

b. *The Market in Higher Education*

If the human-capital hypothesis is correct, the policy implication is that the market in higher education is a free market with slight imperfections that only needs to be rationalized further. Thus, for example, students should be financed by loans rather than scholarships and grants,²⁸ and—more to the point—private educational investment should be treated tax-wise in a way similar to conventional investment. However, this policy approach appears naive when one directly examines the market in higher education.

For starters, the human-capital studies show, at best, only an aggregate competitive rate of private return.²⁹ However, the labor market is far from monolithic; rates of return on education both across and within various occupations are not equal.³⁰ Moreover, studies show diminishing marginal economic returns for incremental education.³¹ Unless these variable rates of

²⁸ See Theodore W. Schultz, *Investment in Human Capital*, 51 AM. ECON. REV. 1, 14–15 (1961).

²⁹ One methodological issue is whether the “private cost” of education should include the “opportunity cost,” *i.e.*, foregone wages. Although conventional economic analysis would take opportunity cost into account, *e.g.*, Becker, *supra* note 10, at 347, the actual opportunity cost of education is not as straightforward as one might assume. See Woodhall, *supra* note 13, at 214–15. It cannot be assumed that one will find immediate gainful employment if one does not attend college. See, *e.g.*, Jacob Mincer, *Labor Force Participation and Unemployment: A Review of Recent Evidence*, in PROSPERITY AND UNEMPLOYMENT 99 (Robert A. Gordon & Margaret S. Gordon eds., 1966). In times of relatively high unemployment, higher education serves a “parking” function. Also, a large percentage of students either work part-time (or even full-time) or receive funds from parents or both, which they otherwise would not have received if they had been working full-time.

³⁰ The distribution of law-practice income of members of the California State Bar, working at least 35 hours per week, in 1990 was as follows: \$200,000 or more, 12%; \$125,000 to \$199,999, 13%; \$100,000 to \$124,999, 10%; \$75,000 to \$99,999, 19%; \$50,000 to \$74,999, 26%; \$25,000 to \$49,999, 14%; and under \$25,000, 4%. SRI INTERNATIONAL, DEMOGRAPHIC SURVEY OF THE STATE BAR OF CALIFORNIA 47 (1991). The median salary for architects in 1990 was \$36,100; the middle 50% ranged from \$27,100 to \$52,400; the top 10% earned more than \$66,300—with some over \$100,000—and the bottom 10% earned less than \$17,900. BUREAU OF LABOR STATISTICS, U.S. DEP’T OF LABOR, BULLETIN NO. 2400, OCCUPATIONAL OUTLOOK HANDBOOK 74 (1992–93). For physicians, the median earnings in 1990 were \$130,000; 25% earned less than \$90,000 and 25% earned more than \$200,000. James W. Moser, *Physician Earnings, 1981–1990*, in SOCIOECONOMIC CHARACTERISTICS OF MEDICAL MALPRACTICE 1992, 18–19 (Martin L. Gonzalez ed., 1992). For dentistry, in 1990 the median was \$80,000; 25% earned less than \$55,000 and 25% earned more than \$115,000. AMERICAN DENTAL ASSOCIATION, THE 1991 SURVEY OF DENTAL PRACTICE 5–6 (1992).

³¹ See Hansen, *supra* note 10, at 134–35.

return are a function of riskiness—which seems unlikely overall³²—significant market imperfections are implicated.³³

Proponents of the human capital hypothesis are shy when it comes to explaining the mechanisms by which prices and returns are correlated. An examination of certain segments of the labor market for persons with postsecondary education suggests that the high rate of return is a function of market imperfections rather than a free market. Thus, business executives can often dictate their own compensation levels.³⁴ Various professions are compensated on a percentage basis rather than an hourly rate. The traditional learned professions, such as law, medicine, dentistry, pharmacy, accountancy, and architecture, restrict entry into the profession by various means, such as licensing, and in some cases are shielded by law from competition by nonlicensed persons. Some professions, such as academia, the civil service, the priesthood, and certain skilled crafts, have obtained a high level of job security in the form of tenure or its near equivalent in lieu of (or in addition to) high wages. At least some professions have the ability to “create” demand for the services they provide.³⁵

In financial markets, prices (values) reflect expected future income streams such that rates of return at given levels of risk (especially low levels) are fairly constant. The higher education market is different. First, it is meaningless to talk about the “value” of higher education, because, once acquired, it cannot be bought and sold in any market. It is true that the human capital of any

³² Increased specialization resulting from incremental graduate, postgraduate, or vocational education would seem to pose a greater risk of obsolescence, yet these forms of education tend to show the lowest rates of return. On the other hand, certain categories of employees (e.g., academics, clerics, civil servants) appear willing to trade possible higher wages for increased job security.

³³ See Blaug, *supra* note 22, at 107. For example, if there are too many graduate students in the liberal arts, either the students lack adequate information about their career prospects as Ph.D.s or else they subordinate their future wage scale to nonmonetary considerations.

³⁴ Cf. John A. Byrne, *The Flap Over Executive Pay*, BUS. WK., May 6, 1991, at 90, 90–96.

³⁵ In general, clients suffer a major informational disadvantage when dealing with the learned professions and are in a difficult position to assess the competence of professional individuals. See AUSTIN SARAT & WILLIAM L.F. FELSTINER, *LEGAL REALISM IN LAWYER-CLIENT COMMUNICATIONS* (American Bar Foundation Working Paper No. 8723, 1987); Austin Sarat & William L.F. Felstiner, *Lawyers and Legal Consciousness: Law Talk in the Divorce Lawyer's Office*, 98 YALE L.J. 1663, 1670–84 (1989) (noting lawyers present themselves as savvy insiders in institutional power structure); see also Abraham S. Blumberg, *The Practice of Law as a Confidence Game: Organizational Cooptation of a Profession*, 1 LAW & SOC'Y REV. 15 (1967), excerpted in AMERICAN COURT SYSTEMS 256 (Sheldon Goldman & Austin Sarat eds., 1989) (explaining how criminal justice institutions and lawyers subsume interests of individual clients); *infra* notes 228–29.

individual has a "rental value" (wage generating capacity) at any given moment, but that value is contingent on many factors and qualities beside education, especially as the date of graduation recedes. Looking, then, solely at prices for higher education, it is hard to see how these prices could produce a standard investment-type return from individual to individual.

Institutionally, the market in private education is riddled with imperfections. Private institutions are heavily subsidized by tax benefits,³⁶ endowments, and public and private aid to (and subsidized loans for) students.³⁷ Supply is relatively unresponsive to short-run fluctuations in demand.³⁸ Tuitions charged by private colleges seem to be highly correlated with nonincome-enhancement factors such as geographical region, selective admissions, and social prestige.³⁹ Due to the inelasticity of supply, oligarchic price-setting is the rule for the numerous selective private institutions; even price-fixing appears to have occurred.⁴⁰ Because the demand for nonselective

³⁶ Gifts and scholarships are excluded from income, I.R.C. §§ 102(a) (1988), 117(a)-(b) (Supp. III 1991), interest on loans secured by a second mortgage on a personal residence and used for education is deductible, I.R.C. § 163(h)(3) (Supp. III 1991), *amended by* 107 Stat. 312, 467 (1993), state and local income and property taxes are deductible, I.R.C. § 164(a) (1988), and contributions to educational institutions are deductible, I.R.C. § 170(a), (c) (Supp. III 1991), *amended by* 107 Stat. 312, 455-56 (1993). The subsidy component of higher education is not considered to be "income." *See, e.g.,* McNulty, *supra* note 2, at 24. Interest on state and local debt is excluded from income, I.R.C. § 103 (1988), which has the effect of lowering the cost of debt issued by state and local governments to finance education or students or both.

³⁷ In 1968, tuition and fees accounted for less than 50% of educational costs in private institutions. *See* Theodore W. Schultz, *Optimal Investment in College Instruction: Equity and Efficiency*, 80 J. POL. ECON. S2, S3-S4 (1974); *see also infra* note 65-66.

³⁸ Particular institutions do not expand and contract enrollment over the short run as student demand waxes and wanes. From time to time, new institutions and programs may appear, while others fall by the wayside, but this process lags far behind shifts in demand. Moreover, a Harvard cannot be created overnight.

³⁹ Harvard, Cornell, Vanderbilt, Colgate, Bennington, University of Chicago, Northwestern, Wheaton, Tulane, Clark, Pine Manor, Kalamazoo, Stanford, Tufts, University of Southern California, and Emory, for example, all charge between \$18,000 and \$21,550 (including tuition, fees, room, and board), despite widely varying prestige and endowments (Duke is only slightly lower). Geography plays a role. Good private colleges in Pennsylvania (Bucknell, Lafayette) tend to charge about \$18,500. Their Virginia counterparts (Randolph-Macon, Hollins, Washington & Lee, and Sweet Briar) are all around \$15,000. Their Texas counterparts (Rice, Southern Methodist, Texas Christian, Baylor, Trinity, and Southwestern) are quite varied (but the variation might be explainable by reference to endowment and religious affiliation). COLLEGE FACTS CHART, 1990-91 (Marggi Roldan ed., 35th ed. 1990).

⁴⁰ *See* Donald R. Carlson & George B. Shepherd, *Cartel on Campus: The Economics and Law of Academic Institutions Financial Aid Price-Fixing*, 71 OR. L. REV. 563 (1992).

private institutions is low, tuitions are low out of necessity, so that the institutional resources are insufficient to provide a competitive educational product.⁴¹ Certainly, it is rare to find price differentials among degree programs *within* a given institution that would reflect possible differences in future wage-stream potential.⁴²

The private cost of attending *public* institutions can hardly be set by a "market," because tuition and fees are an output of the political process, which takes into account tradition (or inertia), the self-interest of politicians, current budgetary constraints, and sometimes the competition for prestige. Residents and nonresidents receive the same education despite vastly disparate tuition levels.

If incremental wages were indeed a function of the cost of higher education, graduates of private colleges should be earning significantly higher wages than graduates of public colleges of equal "quality," even after factoring in opportunity costs.⁴³ Yet there is evidence that credentials (the degree, the major, and grades) are usually more important than either the prestige of the granting institution⁴⁴ or the "quality" of the educational program (per-student expenditures).⁴⁵ And high-prestige public institutions charge far less tuition than do many low-prestige private institutions.⁴⁶ Scholarship aid provided by institutions, mostly based on financial need,⁴⁷ operates as a form of price

See generally Steven R. Salbu, *Building a Moat Around the Ivory Tower: Pricing Policy in the Business of Higher Education*, 75 MARQ. L. REV. 283 (1992).

⁴¹ Institutions facing declining demand cannot easily cut costs (or prices) due to the sunk investment in plant and equipment and salary obligations to tenured faculty.

⁴² See generally D.W. Verry, *University Internal Efficiency*, in ECONOMICS OF EDUCATION, *supra* note 10, at 65. For an indication of differences in starting salaries, see L. PATRICK SCHEETZ, RECRUITING TRENDS 1988-89, 15-21 (Michigan State University 1988). The University of Texas charges higher tuition at certain graduate professional schools than for students in general. This differential is partly justified on the theory that professional school students perceive their education as being motivated by personal gain. In fact, higher and higher levels of education show ever-diminishing marginal rates of return. See *supra* note 24 and *infra* note 240.

⁴³ Also, persons paying nonresident tuition should earn more than those paying resident tuition.

⁴⁴ See JENCKS, *supra* note 15, at 295-96.

⁴⁵ See BOWEN ET AL., *supra* note 10, at 239-43 (providing that little variation among institutions in cognitive value added relative to abilities of incoming students); James et al., *supra* note 24, at 250-51 (providing that per student expenditures have insignificant effect on student earnings, but prestige and selectivity of institution have some effect).

⁴⁶ For example, in 1990-91, the University of California at Davis charged resident tuition and fees of \$1,701, whereas World College West charged \$9,000. COLLEGE FACTS CHART, *supra* note 39, at 10.

⁴⁷ See CHRON. OF HIGHER EDUC., Aug. 28, 1991, at 3, 3.

discrimination among students. Yet aid recipients receive the same education as other students.

Finally, virtually all of the funds spent by students on higher education that they obtained by way of family gift, scholarship, or loan is earmarked exclusively for such purpose. One who spends "free" money would not seek a market rate of return unless alternative market investments were readily available, but they rarely are in the case of potential students.

c. The Consumption Component of Higher Education

It is generally acknowledged that education produces utility beyond an increase in future wages.⁴⁸ This utility is traditionally called "consumption," and analytically takes two forms: (1) current consumption (knowledge for its own sake, an organized social life, increased social status within the college-age population, freedom from authority, avoidance of military service, cultural and athletic opportunities, and freedom in general),⁴⁹ and (2) deferred consumption (more interesting work, a lifelong set of friends and contacts, higher social status, ability to consume culture, and the like).⁵⁰ Direct surveys show that students are motivated to pursue college education not only by an unquantified desire to achieve higher earnings but also by numerous other consumption-type factors.⁵¹ It might also be significant that college students tend to change majors away from math and science into those like social science and education

⁴⁸ See, e.g., W.W. McMahon, *Consumption and Other Benefits of Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 129; see also Edward T. Gullason, *The Consumption Value of Schooling: An Empirical Estimate of One Aspect*, 24 J. HUM. RESOURCES 287 (1989) (attempting to show that current-consumption value of education is positive and is theoretically capable of measurement).

⁴⁹ See *infra* note 51 (showing some strong nonmarket motivations for attending college).

⁵⁰ See RICHARD P. COLEMAN ET AL., *SOCIAL STANDING IN AMERICA* 65-78 (1978); see also Alan D. Mathios, *Education, Variation in Earnings, and Nonmonetary Compensation*, 24 J. HUM. RESOURCES 456 (1988) (providing that nonmonetary rewards increase with level of education relative to monetary rewards). Interestingly, for educated people a sense of well-being is significantly less correlated with income level than is the case with the noneducated, suggesting that higher education (or associated family wealth) gives one an option to pursue relatively low-paying but high-prestige, high-satisfaction occupations, or highly-secure occupations like the ministry, education, the arts, public service, and so on, or both of these types of occupations. See generally ANGUS CAMPBELL ET AL., *THE QUALITY OF AMERICAN LIFE* (1976).

⁵¹ See ALEXANDER W. ASTIN ET AL., *THE AMERICAN FRESHMAN: NATIONAL NORMS FOR FALL 1990*, 16 (1990).

(which often offer lower future earnings potential), rather than the other way around.⁵²

It has been estimated that the consumption value of education approaches equality with the future-earnings value.⁵³ If so, and if the price of higher education correlates with the investment return alone, then higher education is an extraordinary bargain—obviously because of public (governmental) and quasi-public (charitable) subsidies.⁵⁴ But, it is arbitrary, from the policy point of view, to “allocate” the private cost of education entirely to the investment return while (implicitly) matching the consumption component to the public cost. If this method of allocation were taken seriously, there would be virtually no policy justification for government subsidies to higher education or students. Yet the proponents of amortization of educational costs are, in effect, asking for an *additional* government subsidy.

d. *Do Prospective Students Act Like Rational Investors?*

Although students often are influenced by the returns from education, it hardly appears that they act like sophisticated investors.⁵⁵ Surveys of college students indicate that future earnings, in a general sort of way, are strongly considered by many, but by no means all, students, but that various other “consumption” factors are given considerable weight;⁵⁶ also, future earnings appear to be viewed (irrationally) mainly in terms of starting salaries as opposed to lifetime earnings curves.⁵⁷ One study indicates that college students exaggerate the impact of college on their own future income levels.⁵⁸ Persons from poor and uneducated backgrounds generally undervalue investment in higher education relative to cost (including opportunity cost);⁵⁹ in some cases they may simply lack the minimal funds necessary to make the investment. No

⁵² RICHARD B. MCKENZIE & ROBERT J. STAAR, *AN ECONOMIC THEORY OF LEARNING* 30 (1974).

⁵³ Robert H. Haveman & Barbara L. Wolfe, *Schooling and Economic Well-Being: The Role of Nonmarket Effects*, 19 J. HUM. RESOURCES 377, 379 (1984).

⁵⁴ See, e.g., SUBSIDIES TO HIGHER EDUCATION 24 (Howard P. Tuckman & Edward Whalen eds., 1980).

⁵⁵ Schultz, *supra* note 37, at S23, argues that students are sensitive to returns on the basis of the observation that talented people in the 1960s had abandoned pursuing careers in education in favor of law and business. Other factors in this shift must be the civil rights and women's movements, plus the decline in the nonmonetary rewards from teaching.

⁵⁶ See ASTINET AL., *supra* note 51, at 16.

⁵⁷ See J.K. Hinchliffe, *Education and the Labour Market*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 141, 144 (criticizing FREEMAN, *supra* note 11, for not making this distinction in his study).

⁵⁸ Herbert L. Smith & Brian Powell, *Great Expectations: Variations in Income Expectations among College Seniors*, 63 SOC. OF EDUC. 194, 204-06 (1990).

⁵⁹ Becker, *supra* note 10, at 353.

study known to me has found that students actually (1) compare the future earning stream derived from higher education with what they would have earned without the higher education, (2) discount these earning streams to the present, and (3) compare the incremental income stream with the private cost of the higher education (including current wages foregone) or any combination thereof.⁶⁰ Most prospective students are lacking in the basic skills of financial analysis.

To sum up, although it is not surprising that higher education correlates somewhat with incremental earnings (and even more so with increased status), the proposition that the price of higher education is a function of "investment" return in a free market defies logic and observation, especially on an individual basis. The higher education scene, not to mention labor markets in the professions, lack many of the characteristics of a free market, and whatever market exists does not solely pertain to an "investment." It follows that conclusions relating to such a relatively minor issue as the tax treatment of costs of higher education cannot simply be obtained by logical deduction from free-market economic principles.

2. Alleged Inferior Market Status of Educational Investment

The neutrality argument for amortization of higher education costs postulates that education is at a disadvantage compared to conventional investments. This assertion is, of course, directly contradicted by the human-capital hypothesis. Indeed, if the private cost of education yields a market rate of return comparable to conventional investments, and if substantial consumption returns are also produced, it follows that the *total* return on the private cost of education substantially exceeds that for conventional investments.

3. Refining the Neutrality Norm

Neutrality is hardly an absolute: "Optimal taxation" theory posits that facial nonneutrality is sometimes inconsequential,⁶¹ and "second best" theory

⁶⁰ See Hinchliffe, *supra* note 57, at 144-45 (stating empirical evidence does not confirm that demand for education is a function of "investment" return).

⁶¹ Optimal taxation theory is founded on the insight that economic distortions are a function of elasticity. Thus, higher taxes can be imposed on inelastic commodities (such as existence, death, and penicillin) rather than on elastic ones, because the higher taxes on the inelastic commodities will not alter consumer choices and thereby create allocative inefficiencies. See generally Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905, 1945-65 (1987); Joel Slemrod, *Optimal Taxation and Optimal Tax Systems*, 4 J. ECON. PERSP. 157 (1990).

dictates that existing tax nonneutralities should not necessarily be "corrected."⁶²

Optimal taxation theory holds that nonneutral tax rules are harmless where there is a low degree of elasticity (substitutability) between alternative investments. The principal substitute "investments" for higher education are entering the labor force, joining the military, and enjoying leisure (through continued parental support). The making of conventional investments is rarely an available option. Most higher education is undertaken by people in their late teens and early twenties without substantial capital of their own and little or no investment expertise. Parents will spend large sums for their children's higher education—indeed, it may even constitute required "support" under state law⁶³—but not be willing to make gifts of cash or securities.⁶⁴ Massive government-backed loan programs are targeted exclusively for education.⁶⁵ Students would not be able to readily obtain education loans in an unsubsidized private capital market, because they cannot pledge themselves (their future wages) as collateral. Scholarship funds and direct student aid are inherently committed to educational purposes.⁶⁶ Even for students owning capital, parental and peer pressure, not to mention the consumption benefits obtainable through education, might outweigh investment considerations. No study that I

⁶² Removing a tax nonneutrality may actually aggravate allocative inefficiencies in a context of other, nontax, nonneutralities. See generally R.G. Lipsey & R.K. Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956).

⁶³ See Annotation, *Responsibility of Noncustodial Divorced Parent To Pay for, or Contribute to, Costs of Child's College Education*, 99 A.L.R.3d 322 (1980).

⁶⁴ Twenty percent of undergraduates ages 18 to 22 are (apparently) wholly parent financed. John Elson, *Campus of the Future*, TIME, April 13, 1992, at 54, 55. About 80% of students from well-off families receive parental assistance; for middle-income and poor students the figures are 70% and 40% respectively. THOMAS G. MORTENSON, THE IMPACT OF INCREASED LOAN UTILIZATION AMONG LOW FAMILY INCOME STUDENTS 5 (ACT Student Financial Aid Research Report Series No. 90-1). For 1989-1990, it has been estimated that the aggregate national college bill was \$67.5 billion, of which \$38.4 billion was *not* attributable to student aid (including federal loan programs). ROBERT LEIDER & ANNA LEIDER, LOVEJOY'S GUIDE TO FINANCIAL AID 14 (3d ed. 1989). Virtually all of this \$38.4 billion must derive either from family support or from wage income. Gifts of tuition and college expenses would not show up in the data for federal gift tax returns because of the exclusion for direct payments of tuition (§ 2503(e)), the \$10,000 annual exclusion (§ 2503(b)), and the (nonstatutory) exclusion for "support." I.R.C. § 2503 (Supp. III 1991).

⁶⁵ Government-backed education loans awarded in the 1989-1990 academic year amounted to \$12.4 billion. LEIDER & LEIDER, *supra* note 64, at 14.

⁶⁶ For 1990, state and federal student aid totalled about \$6.7 billion dollars. CHRON. OF HIGHER EDUC., *supra* note 47, at 3. Another source comes up with \$9 billion. LEIDER & LEIDER, *supra* note 64, at 14-15. State and federal educational subsidies to institutions are not included in these figures. Scholarship aid provided by institutions (including tuition remission) and other private sources was \$5.7 billion in 1989-1990. *Id.* at 15-16.

am aware of purports to demonstrate that there is any significant elasticity between investment in education and conventional investment, and the proponents of amortization offer no empirical evidence that an amortization deduction would significantly affect the behavior of potential students. People from poorer backgrounds lacking the desire or means to pursue higher education would need much more than a deferred tax benefit in the form of amortization deduction to render higher education a viable option.⁶⁷

Even if elasticity existed, according to the theory of the second best an additional tax benefit for higher education would not improve allocative efficiency, given the existing "tilt" in the playing field in favor of higher education.

B. *Horizontal Equity*

Horizontal equity is sometimes invoked as an argument for amortization (or current deduction) of outlays for higher education.⁶⁸ Horizontal equity is an ethical maxim that posits that persons in the same position should be taxed the same.

1. *Equal Investors?*

One commentator offers the following hypothetical as an argument that failure to amortize education costs is inequitable (and nonneutral): Three brothers have \$10,000 to invest. The choice is among (1) investing in appreciating stock (the investor), (2) investing in depreciable equipment (the entrepreneur), and (3) investing in career-oriented education for one year (the scientist), each of which investment yielded \$30,000 gross (before taxes) after three years.⁶⁹ Because the third alternative produces the worst tax results,⁷⁰ it is asserted that the tax system treats the student inequitably.

Initially, there are some problems with the hypothetical itself. First, as pointed out immediately above, it is unrealistic in assuming that would-be students are commonly dealt a cash endowment that can be freely spent on any of the three specified choices; in the vast majority of cases, only the education option is available. Second, the investor and entrepreneur have their after-tax dollars available to reinvest in the same activity. The student's education, in contrast, has allowed her to enter a profession (science) and to remain in it indefinitely; she does not have to start over again (go back to school or apply

⁶⁷ See *infra* text accompanying notes 209–15.

⁶⁸ See, e.g., Davenport I, *supra* note 1, at 802; Lebowitz, *supra* note 1, at 826.

⁶⁹ See Lebowitz, *supra* note 1, at 825.

⁷⁰ The gross wages are taxed, with no basis offset or amortization deductions.

for a licence) every three years.⁷¹ Third, conventional investment and human capital "cause" income in different ways. A financial investment generates income as a matter of contract right; the owner is purely passive. Productive investment (equipment, and the like) resembles human capital in that it must be combined with personal effort and skill to produce income. But the personal effort and skill can be provided by parties other than the party who supplies the productive investment; ultimately, the supplier of investment need only be a manager of personnel. In any event, if the productive investment is poorly used, it will be acquired by those who can make better use of it—which leads to the fourth point, which is that human capital, unlike investment and productive capital, is not transferable.⁷² Fifth, if the price of education includes significant present or future consumption value or both, the purchaser of education is only partly an investor. Sixth, as pointed out above in connection with the human capital hypothesis, the tax discrimination, if any, is inconsequential, because the cost of education after taxes is still a bargain relative to conventional investments.

One should not also have to make the obvious point that, if indeed there *were* an efficient market in education purely as an investment, there could not be any inequity: The tax regime for human capital outlays would have been factored into the rate of return on human capital, so that the after-tax rate of return for investments in human capital would be comparable to after-tax rates of return on investment capital.⁷³ In that case, the numbers in the hypothetical posing three alternative investment choices would be incorrect.⁷⁴

2. *Equity with Respect to the Financing of Education*

A different form of horizontal equity argument relates to the means by which a student may finance higher education. Specifically, self-financed education is alleged to be at a tax disadvantage compared to gift-based and

⁷¹ Continuing education requires neither the cash outlay nor the opportunity cost of initial education.

⁷² A contract for personal services cannot be enforced by specific performance; even damages are hard to obtain. See DOUGLAS LAYCOCK, *THE DEATH OF THE IRREPARABLE INJURY RULE* 168–72 (1991). See generally Stewart E. Sterk, *Restraints on Alienation of Human Capital*, 79 VA. L. REV. 383 (1993). Although there is a labor market in which employers may attempt to create and deploy human capital, that endeavor is analytically distinct from that of individuals acquiring human capital for their own benefit.

⁷³ See Boris I. Bittker, *Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities?*, in *THE ECONOMICS OF TAXATION* 23 (Henry J. Aaron & Michael J. Boskin eds., 1980).

⁷⁴ But, although there would be "equity," there would also be a misallocation of resources. See JOSEPH M. DODGE, *THE LOGIC OF TAX* 293–95 (1989).

scholarship-based education.⁷⁵ Debt-financed education lies somewhere in between: In general the interest is not deductible, unless the borrowing is secured by a (second) mortgage on a personal residence.⁷⁶

A basic problem with the horizontal equity argument is that it is based on the idea that one or more tax breaks, accepted as "given," command another tax break. The horizontal equity line of argument typically leads to the worst possible kind of tax system. As a matter of logic, horizontal equity concerns can be redressed as well by removing tax breaks as it can by extending them.

On the merits, the scholarship exclusion seems to be basically sound, because scholarships functionally operate as selective price discounts.⁷⁷ Even if the discounted price is viewed as being less than the value of what is received, arms-length bargain purchases of *consumption* should, as I have argued elsewhere, not be viewed as "gross income," because the taxpayer commands economic resources that can be sacrificed to government only in an amount equal to the amount spent (not the "value") of the consumption item.⁷⁸ Assuming that bargain purchases of *assets* should generate income, education is more like consumption than an asset, because neither the education nor the resulting enhancement of human capital can be realized upon currently.⁷⁹

In any event, any amortization deduction would presumably be limited to the after-scholarship cost of education to the student.⁸⁰ Otherwise, the policy of section 265(a)(1) would be violated and write-offs would be generated by before-tax dollars.⁸¹ This observation raises the issue of whether amortization deductions should be available for education financed by excludible gifts and bequests. Amortization should not be allowed, at least in principle, in those

⁷⁵ See Davenport I, *supra* note 1, at 802.

⁷⁶ I.R.C. § 163(h)(3) (Supp. III 1991), amended by 107 Stat. 312, 467 (1993).

⁷⁷ See generally Charlotte Crane, *Scholarships and the Federal Income Tax Base*, 28 HARV. J. ON LEGIS. 63, 69-74 (1991); Joseph M. Dodge, *Scholarships Under the Income Tax*, 46 TAX LAW. 697 (1993).

⁷⁸ Joseph M. Dodge, *Zarin v. Commissioner: Musings About Debt Cancellations and "Consumption" in an Income Tax Base*, 45 TAX L. REV. 677, 680-81 (1990); see Alan Gunn, *Another Look at the Zarin Case*, 50 TAX NOTES 893, 893-95 (1991). See generally Thomas Chancellor, *Imputed Income and the Ideal Income Tax*, 67 OR. L. REV. 561 (1988); Daniel I. Halperin, *Valuing Personal Consumption: Cost Versus Value and the Impact of Insurance*, 1 FLA. TAX REV. 1 (1992).

⁷⁹ Cf. I.R.C. § 83(a) (Supp. III 1991) (receipt by employee of forfeitable and nontransferrable property is not gross income).

⁸⁰ See *Manocchio v. Commissioner*, 78 T.C. 989 (1982), *aff'd*, 710 F.2d 1400 (9th Cir. 1983) (holding no deduction for tuition that generated a tax-exempt scholarship).

⁸¹ The argument might be made that such a rule would have the effect of negating the scholarship exclusion. Crane, *supra* note 77, at 83 n.55. This is not the case at all. The exclusion would be maintained, but a deduction presupposes that the taxpayer has incurred some net cost.

cases where the education directly "caused" the gift.⁸² Because the causal link between gift and education would be much harder to sort out on a case-by-case basis than would be the case with scholarships, it would be necessary to rely on some "formal" rule, such as: (1) no amortization only where the donor directly pays the educational bills, (2) amortization in all gift-financed cases, or (3) no amortization in any gift-financed case. Alternative (1) could be easily circumvented. In choosing between alternatives (2) and (3), a principled advocate of horizontal equity would choose the latter.⁸³

It can be argued that the gift exclusion is merely an income-attribution rule that allocates income to the donor rather than the donee so as to preserve the integrity of the progressive rate schedule.⁸⁴ Despite attribution of the income to the donor, it is then said to be proper that the donee obtain the amortization deduction, in order to properly "match" the outlay to the donee's future wage income.⁸⁵ The problem with this analysis is that the donee has not incurred any net "cost," but only an economic wash. The parent is the one who has incurred the cost in fact, and because the parent is also *treated* as the owner of the income, so *should* the parent be treated as having incurred the cost for tax purposes. The assignment-of-income doctrine supports this conclusion, at least in the case of strings-attached gifts.⁸⁶ Admittedly, current doctrine allows a

⁸² Deductions and basis are not disallowed just because a taxpayer uses a tax-exempt source to make the payment in question. In the policy sense, the issue is, then, "What kind of (causal) relationship between the receipt and the outlay should be deemed sufficient to trigger a disallowance rule?" Cf. I.R.C. § 265(a)(2) (Supp. III 1991) (weak causal nexus for interest expense connected with exempt § 103 interest).

⁸³ Cf. Prop. Treas. Reg. § 1.117-6(c)(1), 53 Fed. Reg. 21688 (1988) (scholarship exclusion not dependent upon tracing).

⁸⁴ This argument assumes the illegitimacy of taxing both the donor and the donee. See Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?*, 89 YALE L.J. 1081, 1088 (1980). I would argue, however, that from an ability-to-pay perspective, both parties have command of the same wealth during the same period, and both should be taxed. See Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978). To say that both donor and donee are treated as part of the same taxable unit is just a fancy way of stating the effect of section 102; it is not a rationale for section 102. Why *should* donor and donee be treated as part of the same taxable unit with respect to gifts (and bequests?) in the context of a tax system that generally treats each individual as a separate taxpayer? The argument that the subject of gifts is "shared" between the donor and donee, see GOODE, *supra* note 2, at 99, is both factually inaccurate and normatively irrelevant. "Support" in kind, as distinguished from gifts, is properly taxed to the provider, who is the person solely in control of the resources. The fact that another person enjoys the resources is irrelevant from an ability-to-pay approach.

⁸⁵ See Argrett, *supra* note 1, at 655.

⁸⁶ In *Helvering v. Horst*, 311 U.S. 112 (1940), the owner of a coupon bond made annual gifts of current coupons to his son. The Court held that the coupon interest was

donee to generally treat the subject of a gift, when expended, as representing a cost incurred by the donee.⁸⁷ Extending this rule to allow amortization of gift-financed education, while continuing to disallow amortization of scholarship-financed education, would overwhelmingly favor the offspring of the upper classes. But the rule for gift-financed expenditures is only based on administrative convenience, namely, the fungibility of cash and resulting difficulty of tracing gratuitous receipts to particular expenditures by the donee. This obstacle is not insuperable; in fact, the same argument was made for maintaining the deduction for personal interest, but Congress rejected it in 1986 by enacting a rule that personal interest is not generally deductible,⁸⁸ and the U.S. Treasury has implemented this command by promulgating a tracing rule.⁸⁹ In the case at hand, an alternative to a tracing rule would be a "stacking" rule that attributed educational outlays "first" to gratuitous transfers received. Regardless of the practical concerns, the "matching" concept adds absolutely nothing to that of "cost" or "loss." Indeed, the matching theory only subverts the amortization argument for gift-financed education, because parents are not the owners of their children's future wage streams.⁹⁰

In the case of a below-market educational loan, which is a bargain purchase of money, the gain is clearly realized in the year of borrowing, economically-speaking.⁹¹ But because the gain on the borrowing is linked to the purchase of education, it can be viewed simply as another form of excludible scholarship.⁹²

As for at-market educational loans, the case for deducting interest must be the alleged connection of the education to future income; if the cost of education should be recovered, so should related interest expense, but not if the cost of education is not recoverable. Being able to deduct interest on personal

taxed to the donor rather than the donee. The best rationale for *Horst* is that the donor controlled the enjoyment of the coupon income. Similarly, in the case of support or strings-attached gifts, the donor controls the expenditure, for which he or she receives no deduction.

⁸⁷ See, e.g., I.R.C. § 1015(a) (1988) (donor's basis carries over to donee).

⁸⁸ See I.R.C. § 163(h)(1) (Supp. III 1991), amended by 107 Stat. 312, 467 (1993) (personal interest not deductible).

⁸⁹ Temp. Treas. Reg. § 1.163-8T(a)(3) (1987).

⁹⁰ Even where the opposite is the case (in some states) for wage incomes of minor children, the income tax law treats the income as that of the child. I.R.C. § 73 (1988).

⁹¹ Below-market educational loans to students apparently do not trigger I.R.C. § 7872 (1988), which focuses mainly on related-party and tax-avoidance loans. See § 7872(c). Even if such a loan generated income to the student, it is conceivable that the benefit would be excluded under I.R.C. § 117 (West Supp. 1993) in whole or in part.

⁹² It would also be excludible as government welfare. In theory, the subsidy could be taxed and the amount of the subsidy increased to cover the tax liability of poor students. Because most students are poor in the income tax sense (gifts, scholarships, and subsidies being excludible), includibility can be dispensed with as an administrative shortcut.

loans just because the loan is secured by a second mortgage on a personal residence is without justification; only the propertied classes benefit.

C. Haig-Simons Income

The Haig-Simons definition of income as consumption plus net increases in wealth is routinely invoked in tax policy discussion. The discussion below demonstrates that the Haig-Simons income concept can only detract from the quality of the analysis.

1. Why Haig-Simons Income?

The Haig-Simons income concept is not self-validating; serious policy issues cannot be resolved by manipulating definitions. One must ask, "Why is Haig-Simons income a plausible norm for the tax base?" Aside from the Constitution,⁹³ the main underpinnings of the Haig-Simons income concept are the norms of ability to pay and neutrality.

a. Ability to Pay

The Haig-Simons income concept is partly validated under the ability-to-pay norm,⁹⁴ under which the ethical obligation of citizens to contribute to the reallocative and redistributive functions of government is a function of the material resources (money and property) they respectively control during a given budget period. A "pure" ability-to-pay tax base would encompass the value of material wealth held at the end of the year plus personal consumption during the year. The Haig-Simons income concept modifies the wealth component for neutrality reasons, as will be pointed out shortly, but otherwise it strongly resembles an ability-to-pay tax base. An ability-to-pay tax would allow deductions off the "bottom" for subsistence (or quasi-subsistence) living

⁹³ An unapportioned federal wealth tax would be unconstitutional, see U.S. CONST. art. I, § 2, cl. 3, whereas an income tax is allowed, U.S. CONST. amend. XVI. The Constitution is not an obstacle to the present scheme of taxing human capital. Refusal of a taxpayer to include wages fully in gross income on the ground that all or a part of them represent a "return of capital" is criminal tax fraud. *E.g.*, *United States v. Sassak*, 881 F.2d 276 (6th Cir. 1989); *United States v. Thibodeaux*, 758 F.2d 199 (7th Cir. 1985).

⁹⁴ Historically, the Haig-Simons concept was promoted as an alternative to other competing definitions of income, such as those that depended on the fruit-tree metaphor, the recurring-receipts idea, or the notion of carving up national income. See generally SIMONS, *supra* note 5, at 59-102. Simons himself appears to have been motivated more from concerns of equity and redistribution than from neutrality per se. See *id.* at 41-43.

expenses and make *some* concessions to liquidity concerns,⁹⁵ and in these respects an ability-to-pay tax actually closer to the present income tax than is the Haig-Simons income concept.⁹⁶

Henry Simons himself opposed write-offs for human-capital acquisition costs.⁹⁷ Although the private acquisition of human capital may create economic value to society, income taxation is not founded on concepts of national wealth but rather on the relative command of material resources by individuals.⁹⁸ Educational outlays do not create wealth that can be alienated or exchanged.⁹⁹ Although it is possible to think of wages as "rent" from the "use" of human capital, the human capital itself can never be bought and sold; the value of it can *only* be revealed in its actual practice or use.¹⁰⁰ Accordingly, the value of

⁹⁵ See DODGE, *supra* note 74, at 91–101. The ability-to-pay norm is neither universally accepted nor always understood. Thus, some commentators view "personal income" as being a person's share of the national income "pie." See, e.g., Norman H. Lane, *A Theory of the Tax Base: The Exchange Model*, 3 AM. J. TAX POL'Y 1, 5–40 (1984); Warren, *supra* note 84. Such a concept, if embodying fairness criteria at all, is incompatible with the ability-to-pay concept. For example, transfers received are ignored under the "pie" approach but are included in an ability-to-pay tax base. It is clear that Henry Simons rejected the pie approach, see SIMONS, *supra* note 5, at 207, and followed the ability-to-pay approach, because, *inter alia*, he proposed including gratuitous receipts in income.

⁹⁶ The present income tax does not consider imputed income to be "income," and gains and losses are generally taken into account only when "realized" or "sustained." I.R.C. § 165(a) (1988), *amended by* 107 Stat. 312, 485 (1993); I.R.C. § 1001(a) (1988), *amended by* 107 Stat. 312, 340 (1993). Various deductions "off the bottom" include the standard deduction, I.R.C. § 63(c) (Supp. III 1991), *amended by* 107 Stat. 312, 459 (1993), the deduction for personal and dependency exemptions, I.R.C. § 151(a), (c) (West Supp. 1993), *amended by* 107 Stat. 312, 459 (1993), the deduction for medical expenses, I.R.C. § 213 (Supp. III 1991), *amended by* 107 Stat. 312, 435 (1993), the deduction for alimony payments, I.R.C. § 215 (1988), and possibly the deductions for business travel lodging, state and local income and property taxes, personal casualty losses, and moving expenses, I.R.C. § 162(a)(2) (West Supp. 1993), *amended by* 107 Stat. 312, 435 (1993), I.R.C. § 164(a) (1988), I.R.C. § 165(c)(3), ch. 7 (1988), *amended by* 107 Stat. 312, 485 (1993), and I.R.C. § 217 (Supp. III 1991), *amended by* 107 Stat. 312, 473 (1993).

⁹⁷ See *infra* note 102.

⁹⁸ See *supra* notes 94–95.

⁹⁹ Alvin C. Warren, *Comments by Alvin C. Warren, in WHAT SHOULD BE TAXED: INCOME OR EXPENDITURE?* 124–25 (Joseph A. Pechman ed., 1980).

¹⁰⁰ See Davenport I, *supra* note 1, at 846–48. Note that this result *potentially* violates the neutrality norm, because conventional investment assets are normally included in gross income when acquired. See I.R.C. § 74 (1988) (prizes), I.R.C. § 83 (Supp. III 1991) (property received for services). Nontransferability is not a per se ground for exclusion from the tax base. Thus, under § 83(a) the receipt of property by a services provider is income even though the property is not transferable. (Inclusion is prevented here only if a transferee would take subject to conditions of forfeiture.) See § 83(c)(2). In the section 83

any accession to human capital, such as the incremental value of one's future wage stream acquired through higher education, would not be included in the tax base, because it cannot be meaningfully realized upon until the wage stream actually materializes. Similarly, no amortization deductions would be allowed, because the process of earning wages would not entail a decrease in the value of realizable-upon "wealth." Because amounts spent to acquire human capital no longer inhere in exchangeable assets,¹⁰¹ they are "destroyed" at the time the outlays are incurred, and therefore, they constitute "personal consumption" as Simons conceived it.¹⁰²

Thus, although the human capital hypothesis suggests that educational outlays are at least in part a capital expenditure, if the resulting asset (human capital) is ignored for tax purposes, the educational outlay should be treated as an expense! Because outlays of cash manifest the command by the taxpayer of material resources, the ability-to-pay norm dictates that the outlay be nondeductible unless there is a good (economic or distributional) reason to deduct it.

A plausible case can be made for the proposition that *parents* should be able to deduct educational outlays according to the ability-to-pay concept of "nondiscretionary expenditures."¹⁰³ The argument would be that parental support for at least college (if not graduate) education is both extraordinary in amount and "compelled" either by law or convention. Defining and identifying nondiscretionary outlays entails the exercise of social and political judgment, which can be viewed as either a strength or a weakness of this approach.¹⁰⁴

situation the employee would bargain to receive illiquid assets only if illiquidity to pay taxes is not a major concern. Accessions to human capital are on a far more pervasive scale.

¹⁰¹ The fact that knowledge and other personal characteristics can be "passed on" by teachers, parents, and so on, does not mean that they are transferred, because the teacher, parent, and others give up nothing. "Replicated" is a more accurate word, but even that misses the mark, because whatever is passed on is reconstituted by the "transferee" in the latter's own personhood and actions.

¹⁰² See SIMONS, *supra* note 5, at 50, 54.

¹⁰³ See 3 REPORT OF THE ROYAL COMMISSION ON TAXATION 1-24 (1966) (Can.). The notion of subsistence and nondiscretionary expenses is typically used to justify the personal and dependency exemptions, the standard deduction, the medical expense deduction, the deduction for state and local taxes, and the deduction for alimony. See DODGE, *supra* note 74, at 122-29; Thomas D. Griffiths, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343 (1989); see also William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 331-43 (1972) (discussing medical expense deduction); William J. Turnier, *Evaluating Personal Deductions in an Income Tax—The Ideal*, 66 CORNELL L. REV. 262, 288-93 (1981) (discussing state and local taxes).

¹⁰⁴ See, e.g., Boris I. Bittker, *Income Tax Reform in Canada: The Report of the Royal Commission on Taxation*, 35 U. CHI. L. REV. 637, 658-59 (1968); Walter J. Blum, *Progressive Taxation Reconsidered—North of the Border*, 45 TAXES 718 (1967); Joel S.

The fact that something is widely valued does not make the cost of it nondiscretionary; otherwise, desires would be too readily converted into "necessities" and then into "rights."¹⁰⁵ Also, one might balk at allowing an expense whose "nondiscretionariness" increases as one ascends the social ladder.

Allowing a deduction to parents would be inconsistent with allowing any tax write-offs to their children for gift-financed education.¹⁰⁶ Clearly the student cannot invoke the nondiscretionary-outlay concept; the student must invoke other norms.

b. *Neutrality*

The Haig-Simons income concept is a compromise between the ability-to-pay and neutrality norms, which are inherently in tension. On the macro level, while ability-to-pay posits that the tax base be constituted with reference to all material resources over which the taxpayer has control (indicating a wealth tax), neutrality dictates that the material resources of a taxpayer not be taxed over and over again. Accordingly, under an income tax, given dollars of wealth are only taxed once regardless of how many years the dollars are held by the taxpayer. But neutrality itself is challenged by the theories of optimal taxation and the second best.¹⁰⁷ Thus, on the micro-tax policy level, opinions can differ as to how far ability-to-pay should go to accommodate economic policy criteria as well as other criteria such as distributional concerns and, perhaps, administrative convenience.¹⁰⁸

Because the causal connection between educational outlays and incremental wages may be weak or nonexistent in particular instances, it can be assumed that disallowing amortization would result, at worst, in something less than double taxation in the aggregate. Over-taxation of the same human-capital dollars is only harmful, from the allocative efficiency point of view, if it results in under-investment in human capital relative to other competing uses of funds. This proposition seems doubtful for the reasons stated earlier.¹⁰⁹

Newman, *The Deductibility of Nondiscretionary Personal Expenses*, 6 AM. J. TAX POL'Y 211 (1987).

¹⁰⁵ An example of this kind of thinking can be found in Susan H. Bitensky, *Theoretical Foundations for a Right to Education Under the U.S. Constitution: A Beginning to the End of the National Education Crisis*, 86 NW. U. L. REV. 550 (1992).

¹⁰⁶ If the rationale for the gift exclusion is that the subject of a gift should be taxed only once within the family unit, it would be inconsistent with this rationale to allow write-offs to both the donor and the donee with respect to the same expenditures.

¹⁰⁷ See *supra* text accompanying notes 61-62.

¹⁰⁸ Most obviously, the goal of maximizing aggregate social wealth is generally incompatible with that of achieving an equitable distribution of wealth and opportunities.

¹⁰⁹ See *supra* pp. 930-43.

Human capital extends beyond education to include items such as genetic endowment, family and social environment, gifts, bequests, support, scholarships, government aid, being hired, being promoted, and acquiring seniority or tenure. Overall, it seems likely that human capital is treated as well or better under the tax system than is investment capital.¹¹⁰ Except for nondeductible self-financed costs of education, human capital is mostly acquired tax-free. The exclusions for these accessions to human capital can be justified on various grounds, such as universality (birth, compulsory schooling),¹¹¹ impossibility of valuation,¹¹² the inability to "realize upon" the accession, and the high value placed upon personal autonomy.¹¹³ In any event, an exclusion is the equivalent of a deduction,¹¹⁴ and the deduction of investment is the financial equivalent of exempting all future income; in contrast, conventional investment income is, in the financial sense, "taxed twice" under an income tax, even with capital recovery.¹¹⁵

As noted earlier,¹¹⁶ even if human capital were viewed as being treated worse than investment capital, the error would be "harmless," because there is little elasticity between human capital and investment capital. Indeed, the amortization proposal is itself nonneutral with respect to alternative means of acquiring human capital. Only costs of higher education would be favored;

¹¹⁰ McNulty, *supra* note 2, at 22-26; L.G. Sgontz, *Does the Income Tax Favor Human Capital?*, 35 NAT'L TAX J. 99, 103 (1982); Paul B. Stephan III, *Federal Income Taxation and Human Capital*, 70 VA. L. REV. 1357, 1371-72, 1409-10 (1984). This point has nothing to do with the exclusion of the opportunity cost of acquiring education (foregone earnings). See Argrett, *supra* note 1, at 626-27. Opportunity cost is ignored by the tax system. The opportunity cost of education is probably substantially overrated in any event, see *supra* note 29.

¹¹¹ Because the function of the tax base is to allocate the aggregate personal income tax burden among the population in accordance with a quantitative index, it is pointless to include in the tax base positive items that all taxpayers share (or have access to) equally, such as life, oxygen, and basic government services.

¹¹² See JOSEPH T. SNEED, *THE CONFIGURATIONS OF GROSS INCOME* 41-49 (1967); DODGE, *supra* note 74, at 136-37.

¹¹³ See, e.g., Alan Gunn, *The Case for an Income Tax*, 46 U. CHI. L. REV. 370, 382-83 (1979); Warren, *supra* note 99, at 124-25.

¹¹⁴ The treatment of human capital accessions is the functional equivalent of including them in income and taking an offsetting deduction in full.

¹¹⁵ The nondeductible cost of an investment represents the present discounted value of all future cash flows, principal, and income. Because the income is taxed when accrued or received, this income portion is taxed twice. See, e.g., DODGE, *supra* note 74, at 220-21.

¹¹⁶ See *supra* text accompanying notes 63-67.

other costs pertaining to human capital, many of which are not difficult to identify,¹¹⁷ would be ignored.

2. *What Is Consumption?*

Arguments about whether outlays for higher education constitute consumption, which should not produce tax benefits, ultimately lead nowhere, because the idea of “consumption” is itself subordinate to such “higher” norms as ability-to-pay and allocative efficiency. The essence of the concept of income (as opposed to that of wealth) is that the “same” dollars are not taxed twice nor deducted twice. Basis recovery prevents the same dollars from being taxed twice where the initial outlay was a nondeductible capital expenditure. An “expense” is conventionally defined as an outlay that produces no ascertainable future benefit that lasts beyond the current year. Nevertheless, the concept of “expense” is somewhat of a fiction; at least business and investment expenses are made with the aim of producing present or future income.¹¹⁸ Of course, income represents the same dollars as an expense in only a loose sense: It is (usually) impossible to match a given expense item to a given income item. The same point can be made about depreciation and losses with respect to physical assets.¹¹⁹

The weak causal link between gross income, on the one hand, and business expenses, depreciation, and losses, on the other, is the reason why the latter are *prima facie* deductible.¹²⁰ But the tax law must be—and is—skeptical in situations where outlays might be ends in themselves rather than means to the end of producing incremental revenue.¹²¹ Expenses, depreciation, and losses

¹¹⁷ Some other outlays relating to the acquisition of human capital are job-seeking expenses, moving expenses, continuing education outlays, and health-oriented expenses. *See infra* text accompanying notes 171–93.

¹¹⁸ *But cf.* William A. Klein, *Income Taxation and Commuting Expenses: Tax Policy and the Need for Nonsimplistic Analysis of “Simple” Problems*, 54 CORNELL L. REV. 871 (1969); William A. Klein, *Tax Deductions for Family Care Expenses*, 14 B.C. INDUS. & COM. L. REV. 917 (1973) (basing equity and neutrality analysis on likely motivations of typical taxpayers).

¹¹⁹ A financial instrument like an annuity or debt obligation provides for a return as a matter of contract. Even shares of stock commonly entail a claim against net worth upon liquidation.

¹²⁰ For the same reason, net operating loss carryovers are appropriate as a matter of principle. *See Dobson v. Commissioner*, 320 U.S. 489, 492–94 (1943) (holding recovery of prior loss not producing tax benefit is excludable), *implicitly overruling Burnet v. Sanford & Brooks Co.*, 282 U.S. 359, 364 (1931) (denying loss carryover); *see also* DODGE, *supra* note 74, at 25–27.

¹²¹ *See* section 162(a)(2) (business travel meals and lodging not involving overnight stay) and the following provisions of I.R.C. section 274 (Supp. III 1991), *amended by* 107 Stat. 312, 469 (1993): (a) (additional hurdles for deducting business entertainment outlays),

(i.e., "consumption") that are ends in themselves must be taxed then or never, because they do not create future income. This broad concept of consumption differs from the conventional view that consumption is identified by personal utility. One point of difference is that the broad view of consumption encompasses wanton or predictable economic waste.¹²²

In a clear business setting, the tax system relies on the taxpayer's business judgment (and the judgment of the business community) in deciding what is income related.¹²³ In borderline cases, however, the system allows deductions to the extent of the gross income only; the outlays are deemed to have "caused" the gross income, but the net losses are deemed not to have caused any (current or future) income and are therefore permanently disallowed.¹²⁴ This "objective" method of line-drawing explains why personal pleasure or utility is only a "factor" in considering nondeductibility; pleasure by itself is (properly) never sufficient to deny deductibility.¹²⁵

Where does this causal-nexus theory of business deductions lead in the case of costs of higher education? On the one hand, if education really does create or improve human capital (wage-earning capacity), the cost of it arguably should be recovered in full, notwithstanding the acknowledged substantial pleasure component.¹²⁶ More precisely, to the extent that education correlates with *incremental* human capital, cost recovery should be allowed against *incremental* income attributable to the education.¹²⁷

Moreover, that education might possess a dual investment-consumption character does not inevitably lead to the conclusion that an allocation of cost between the two is proper.¹²⁸ An allocation would be in order only where it

(c) (foreign business travel), (h) (foreign conventions, conventions aboard cruise ships, and "investment" seminars), (k), (n) (business meals and entertainment), (l) (entertainment tickets and skyboxes), (m) (luxury water transportation; travel as form of education). See also I.R.C. § 280F (Supp. III 1991) (luxury automobiles, other vehicles, computers, and cellular telephones used in business).

¹²² Net losses from nonpleasure activities that generate wanton economic waste are not deductible. *E.g.*, *Surloff v. Commissioner*, 81 T.C. 210 (1983). Under ability-to-pay, these losses, as well as losses on consumer assets, represent economic resources commanded by the taxpayer during the year and not devoted to income-producing activity.

¹²³ *Welch v. Helvering*, 290 U.S. 111, 112-14 (1933) (construing "necessary" and "ordinary" under I.R.C. § 162 (West Supp. 1993)).

¹²⁴ See § 183 (not-for-profit activities) and I.R.C. § 280A (1988) (business use of home).

¹²⁵ See *supra* note 122.

¹²⁶ See *supra* text accompanying note 120.

¹²⁷ This more narrow rule raises technical problems of implementation. For example, should the write-off be altered or denied if the incremental human-capital income is accelerated (by way of "signing" bonuses), deferred, or simply lies fallow?

¹²⁸ Cf. Halperin, *supra* note 2, at 862-63, 886 (providing that in theory, only excess of outlay over consumption value is a business expense); William A. Klein, *The*

could be shown that the private cost of education exceeded the value of the incremental future wage stream, because this excess would necessarily represent consumption. However, there is insufficient evidence at the present to support any allocation to consumption on this basis.¹²⁹ Others have argued that the investment component of an outlay is the excess of cost over its consumption value.¹³⁰ Although it is probably easier to value the consumption component directly as opposed to the investment component in some areas, such as business meals and entertainment, in principle, if investment return can be identified, it should crowd out consumption, because "income" essentially means avoidance of double taxation, not taxing utility as such.¹³¹

The foregoing analysis does not clinch the issue in a situation, such as that involving higher education, where the combined consumption-investment value exceeds the private cost due to heavy public and quasi-public investment. There is no principled basis for saying that the investment return should be matched to the private cost—leaving the consumption return to be allocated to the public cost—but neither is there a principled basis for taking the opposite approach.

It is obvious that taxpayers cannot be allowed to plead that human-capital outlays are business-motivated on a case-by-case basis. The administrative burden would be intolerable, and taxpayers' testimony would be self-serving and unreliable.¹³² It follows that some clear-cut rule, even if arbitrary, is

Deductibility of Transportation Expenses of a Combination Business and Pleasure Trip—A Conceptual Analysis, 18 STAN. L. REV. 1099, 1104–18 (1966) (discussing causation-based rules and allocation rules).

¹²⁹ See *supra* note 53 and accompanying text.

¹³⁰ See, e.g., Halperin, *supra* note 2, at 862–63.

¹³¹ Although certain tax rules (such as the rate structure and the personal exemptions) may be founded on utility concerns, it does not follow that the object of taxation is to tax utility as such, because utility is not capable of interpersonal comparison and is not apprehendable by the government. Thus, it is erroneous to assume that the value of leisure or self-provided services should be included in the tax base, although "neutrality" considerations may point the other way. See Chancellor, *supra* note 78, at 593–601; Dodge, *supra* note 78, at 680–83; see also Daniel Shaviro, *The Man Who Lost Too Much: Zarin v. Commissioner and the Measurement of Taxable Consumption*, 45 TAX L. REV. 215, 251–52 (1990) (rejecting utility-based tax-base rules due to practical considerations). But cf. Andrews, *supra* note 103, at 331–43 (suggesting that medical expenses are properly deductible because they produce no utility above a baseline of normality); Michael J. McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573, 1592–99 (1977) (justifying joint-return system because spouses share enjoyment of family income). Of course, income-attribution issues are typically resolved according to control, not enjoyment, of economic resources. See, e.g., §§ 73, 102(a); *Helvering v. Horst*, 311 U.S. 112, 119 (1940); *Helvering v. Clifford*, 309 U.S. 331, 334–35 (1940); *Lucas v. Earl*, 281 U.S. 111, 112 (1930).

¹³² Surveys indicate that students tend to overrate the effect of education on their own earnings. See *supra* note 58.

necessary. Given that tax "justice" is not at all possible in this area, economic (and other normative) considerations should ultimately control. Decisive is the fact that the no-double-taxation principle inherent in the Haig-Simons income concept is ultimately grounded in the concept of neutrality, which itself—as mentioned earlier—is not an "absolute" in the realm of economics. Thus, for the reasons stated earlier (and later), amortization cannot be justified. If the resulting categorization of human-capital outlays as "personal" is viewed as a mere concession to "administrability," so are other major structural decisions in the income tax,¹³³ suggesting that perhaps there is a point at which administrability concerns rise to the status of "principle."

Nor can a convincing case be made for singling out professional or vocational education or both for favorable tax treatment.¹³⁴ Although it is commonly thought that prospects for higher income are typically the dominant motive here,¹³⁵ three problems persist. First, returns on education do not increase as one moves up the educational ladder;¹³⁶ nor does it appear that vocational education is generally a sound investment.¹³⁷ Second, the desire to acquire a trade or profession is as much or more likely to relate to lifestyle and status than to incremental income.¹³⁸ Third, under standard capitalization doctrine all steps in the acquisition of an asset must be capitalized, not just the last step.¹³⁹ Would the proponents of amortization of professional and

¹³³ The realization principle, depreciation schedules, the failure to index for inflation, and (perhaps) the exclusion of imputed income from consumer goods are commonly attributed largely to administrability concerns, although this explanation may not be fully adequate. For example, it has been argued that not taxing imputed income is justified on fairness grounds. See Chancellor, *supra* note 78, at 598–600. The standard deduction and the floors under miscellaneous itemized deductions, the medical expense deduction, and the personal casualty loss deduction are other examples.

¹³⁴ Cf. Halperin, *supra* note 2, at 904 (providing that the cost of this education, but not college education, should be amortized, because the former presumably has minimal consumption aspects).

¹³⁵ It is generally assumed that the consumption component of education decreases as one progresses through the system, being at its lowest in professional and vocational school. E.g., Alan Gunn, *The Requirement that a Capital Expenditure Create or Enhance an Asset*, 15 B.C. INDUS. & COM. L. REV. 443, 479–80 (1974); Lebowitz, *supra* note 1, at 827–28; McNulty, *supra* note 2, at 18–19 (expressing some uncertainty).

¹³⁶ See Hansen, *supra* note 10.

¹³⁷ See GEORGE PSACHAROPOULOS, RETURNS TO EDUCATION: AN INTERNATIONAL COMPARISON 5, 71–72 (1973) (Neth.) (detailing cross-cultural comparison of vocational-technical versus general education).

¹³⁸ See *supra* note 50.

¹³⁹ E.g., *Woodward v. Commissioner*, 397 U.S. 572, 575 (1970); *Sun Co. & Subs. v. Commissioner*, 677 F.2d 294 (3d Cir. 1982). In *Sharon v. Commissioner*, 66 T.C. 515 (1976), *aff'd per curiam*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979), the court disallowed the cost of taking a bar review course, while allowing amortization of

vocational education really want to go so far as to allow amortization of the cost of all education, from birth forward, in the name of "perfecting the definition of income"?¹⁴⁰

The foregoing discussion of the consumption issue, which actually was "slanted" in favor of the case for amortization, does not really add anything to what was stated before, for the simple reason that the consumption concept itself adds nothing to the key norms of ability-to-pay and allocative efficiency. This point reinforces the prior point that the Haig-Simons income concept has no independent value in tax policy analysis.

3. A "Consumption" Income Tax

Further light on the human capital issue might be shed by an examination of the treatment of human capital under a "consumption income tax." Under the "cash flow" version of the consumption income tax, all receipts (including borrowings and sales proceeds) are fully included in the tax base but all business and investment outlays, including capital expenditures, are fully and currently deductible. Under the alternative "wage" tax version, wage income is fully includible, business and investment capital expenditures are not deducted, but all business and investment positive cash flows are exempt from tax.¹⁴¹ These two versions are conceptual equivalents to each other in the business and investment realm, because the cash-flow method of including all cash flows while deducting the investment is the financial (*i.e.*, present value) equivalent of the wage-tax method of not deducting the investments but exempting the cash flows.¹⁴² There would be differences in their actual applications:¹⁴³ The cash flow version would be considered more "fair" because the tax base would be keyed to actual investment outcomes,¹⁴⁴ whereas the wage tax would be

the cost of gaining admission to the bar, on the ground that the bar review course was "education," not a cost of obtaining the license. This reasoning is simply conclusory.

¹⁴⁰ From both an equity and neutrality perspective, compulsory education should not enter into the tax base, because it is a universal attribute of taxpayers. Therefore, it cannot be a basis for comparing taxpayers, nor has the resource-allocation issue been left open.

¹⁴¹ That is, business and investment income and gains are fully excluded. *See generally*, U.S. DEP'T OF TREAS., BLUEPRINTS FOR BASIC TAX REFORM 9-12 (1977).

¹⁴² Because the cost of an investment is the present value of future cash flows, it does not matter, *ex ante*, whether one deducts the investment or excludes the cash flows from income.

¹⁴³ Actual cash flows may differ from the cash flows represented in the purchase price. Thus, a wage tax produces a better result for an investor than the cash flow tax where actual cash flows exceed the projections thereof embodied in the initial price.

¹⁴⁴ Actual cash receipts, whether wages, income, sales proceeds, or borrowings, are included in the cash flow tax base, whereas under the wage tax, business and investment net income and gains are ignored.

more "neutral" because equal-priced investments would be taxed the same *ex ante*.¹⁴⁵

Under both versions of the consumption tax, there would be no deduction for educational outlays (or any other human capital acquisition costs) and no (full or partial) exclusion of wage income.¹⁴⁶ It is axiomatic that under the wage-tax version gross wage income would be fully subject to tax. Even under the cash flow version, gross wage income would be subject to tax sooner or later.¹⁴⁷

The chief appeal of the consumption tax is that it is "more" neutral both between consumption and investments and among conventional investments than is the income tax, because the consumption tax avoids the financial "double taxation" of conventional investment income that occurs under the income tax.¹⁴⁸ Neutrality between conventional investments and human capital investments is simply not an issue. *From a lifetime perspective, "consumption" is equated with gross wage income.*¹⁴⁹

If gross wages are taxed under a consumption tax, it must mean gross wages are fully taxed under an income tax.¹⁵⁰ An income tax base is broader than a consumption tax base, of course; it includes changes in material

¹⁴⁵ Investments *costing* the same would be taxed the same by virtue of disallowing any deductions with respect to the purchase price and ignoring actual cash flows.

¹⁴⁶ See U.S. DEP'T OF TREAS., BLUEPRINTS FOR BASIC TAX REFORM, at 55, 116, 143 n.1 (1977).

¹⁴⁷ Wages would not be fully taxed when received, to the extent committed to business and investment outlays, but the cash flows produced by these outlays would be fully taxed. Although not all investments will have been reduced to cash by death, the date-of-death value of such investments should be taxed by reason of death. A subissue is whether this wealth should be taxed to the transferor or to the transferee. See U.S. DEP'T OF TREAS., BLUEPRINTS FOR BASIC TAX REFORM, at 137 (1977) (stating recipient should be taxed); Dodge, *supra* note 84, at 1187 (providing that transfers should be taxed to transferor under cash flow tax analogue to the tax benefit rule, the idea being that the original deduction for the investment was premised on eventual taxation to the investor); Michael J. Graetz, *Expenditure Tax Design*, in WHAT SHOULD BE TAXED: INCOME OR EXPENDITURE?, at 161, 200-02 (Joseph A. Pechman ed., 1980).

¹⁴⁸ This income is taxed *ex ante* (wage tax) or *ex post* (cash flow tax), but not both at the front and back end. See David Bradford, *The Case for a Personal Consumption Tax*, in WHAT SHOULD BE TAXED: INCOME OR EXPENDITURE?, at 75, 96-101 (Joseph A. Pechman, ed., 1980). Under the income tax, the nondeductibility of the purchase price as a capital expenditure is the "first" tax, because the purchase price is the present discounted value of all future receipts, principal, and income; the income is taxed again when received or accrued.

¹⁴⁹ The statement in the text holds true, under the cash flow tax, only if gratuitous transfers are taxed to the transferors, not the transferees. See *supra* note 147.

¹⁵⁰ See U.S. DEP'T OF TREAS., BLUEPRINTS FOR BASIC TAX REFORM, at 54-55 (1977).

wealth.¹⁵¹ All of the rules of the income tax (other than those relating to personal deductions, among others) are simply "accounting" rules pertaining to the measurement of conventional business and investment income from year to year. In any given year, income may be more or less than gross wages, but (disregarding personal deductions, among others, plus deductions derived from gifts)¹⁵² lifetime income can never (normatively) be less than gross wage income. Thus, "lifetime" Haig-Simons income can be described as "gross wage income plus other net accessions to wealth." The "consumption" idea is again superfluous.¹⁵³

4. *Taxation of Human Capital*

In conformity with Simons's theorizing, the tax law ignores both accessions to, and losses of, human capital.¹⁵⁴ The call for amortization of the

¹⁵¹ If one invests \$10,000 (the present value of all future cash flows from the \$10,000) and receives \$17,000 in cash over the future life of the asset, \$7,000 is "income." Recovery-of-capital rules tell us *which* part of the \$17,000 is "income" and *which* part is "principal," and when this is the case.

¹⁵² If, following Henry Simons, gratuitous receipts were included in income, this exception would disappear.

¹⁵³ See Joseph Isenbergh, *The End of Income Taxation*, 45 TAX L. REV. 283, 308-10 (1990) (arguing that, because all savings are eventually consumed, the core of the income taxation is ultimately consumption); Calvin H. Johnson, *Soft Money Investing Under the Income Tax*, 1989 U. ILL. L. REV. 1019, 1062-63 (1989). Accumulated wealth entails more than future consumption: it yields power, status, financial security, and flexibility. Although the utility derived from these benefits is not included as such in the tax base, their presence can plausibly lead to the view that savings should not be wholly exempt from tax. See, e.g., Mark Kelman, *Time Preference and Tax Equity*, 35 STAN. L. REV. 649, 658-60 (1983); Jeff Strnad, *Periodicity and Accretion Taxation: Norms and Implementation*, 99 YALE L.J. 1817, 1832-39 (1990). See generally Warren, *supra* note 99. The proposition that savings is future consumption is misleading in two ways. First, it ignores waste and value depreciation. Second, savings is not necessarily converted to consumption by the same taxpayer or even a succession of related taxpayers. The income tax focuses on individuals rather than family trees. Simply defining "consumption" to encompass the making of gratuitous transfers will not suffice.

¹⁵⁴ I disagree with Paul Stephan, *supra* note 110, at 1387-1405, who argues that the current tax system takes human capital into account in several instances. For example, the notion that medical expenses are deductible as a "repair" to human capital is rebutted by the design of the section 213 deduction itself: the deduction is available with respect to illnesses and conditions that do not impair human capital, and the 7.5%-of-AGI "floor" under the deduction has no counterpart for normal repair deductions. The deduction, including the floor, can better be rationalized on the ground that extraordinary amounts of such expenses are, in the main, nondiscretionary and above the norm, which is accounted for by the standard deduction, personal exemption, and lower marginal rate brackets. See DODGE, *supra* note 74, at 122-29; cf. Andrews, *supra* note 103, at 335-37 (noting deduction

cost of any category of education raises a slippery slope problem, because virtually any outlay (including one relating to personal appearance, socializing, entertainment, and family) can arguably improve wage-earning capacity. An income tax base would be feeble indeed if borderline human-capital situations were systematically treated as being business-related. It is proper for current law to treat them as "personal."¹⁵⁵

Human capital is not analogous to situations involving alternating business and personal use over time or in space, which mandate allocations between business and personal use.¹⁵⁶ Rather, human capital, Janus-like, simultaneously presents business and personal "faces." Human capital pertains not only to income-producing capacity but also to the ability to enjoy both life and work more broadly and fully. As the saying goes, "Do people work to live, or do people live to work?"¹⁵⁷ Even focusing on employment, obtaining higher (or vocational) education enables one to earn a living in a certain way or at least expands one's employment options. Choosing one way of making a living over another is essentially a *personal* choice, an end in itself (consumption, if you insist), rather than a means to an end.¹⁵⁸ Career decisions, like marriage and home-buying decisions, are pervasive to how everyday life is lived, and should be categorized as "personal."¹⁵⁹ Finally, education is not a money machine; it

restores taxpayer to the norm). The maintenance of good health is viewed in economics literature as one mode of human capital acquisition. See BECKER, *supra* note 10, at 40-41. Nevertheless, general health maintenance costs are not deductible under section 162 or section 213 and are simply ignored by the tax system. Treas. Reg. § 1.213-1(e)(1) (1957) (as amended in 1979). Although the I.R.C. section 104 (Supp. III 1991) exclusion is commonly rationalized under a "replacement of capital" theory, consistency with that rationale would dictate deduction of uncompensated loss. For an alternate rationale for excluding recoveries for lost human capital, see Joseph M. Dodge, *Taxes and Torts*, 77 CORNELL L. REV. 143 (1992). As for job-search expenses and moving expenses, see *infra* notes 181-91 and accompanying text.

¹⁵⁵ Fifty percent of business meals and entertainment are disallowed under section 274(n). See also section 280F(d)(3), which disallows any deduction for employee use of "listed property" except where the use is a condition of employment and for the convenience of the employer. These rules operate in the context of outlays that the Internal Revenue Service (IRS) concedes to be primarily business motivated or for which case-by-case enforcement would be too difficult.

¹⁵⁶ For example, use of a car or home for part-personal and part-business use generates deductions keyed to the percentage of business use.

¹⁵⁷ SIMONS, *supra* note 5, at 74 (citing 39 *Finanz Archiv* 408-11 (Georg Schanz ed., 1921) (Germany)).

¹⁵⁸ See Rev. Rul. 77-254, 1977-2 C.B. 63 (providing that outlays for general search for, or preliminary investigation of, business or investment are "personal").

¹⁵⁹ This seems to be Justice Cardozo's main point in *Welch v. Helvering*, 290 U.S. 111 (1933). See also U.S. DEP'T OF TREAS., BLUEPRINTS FOR BASIC TAX REFORM, at 55 (1977) (noting choice of occupation, place of residence, and place of employment are all "personal"); Alan Gunn, *supra* note 135, at 477-80. Under section 104, the fact that a

must be combined with such purely personal attributes of the individual as motivation, personality, ability, and (above all) the taxpayer's time and effort to realize its nontransferable potential.¹⁶⁰

D. Other Issues Involving Human Capital

1. How Would Human Capital Be Written Off?

Assuming that higher education costs should be amortized at all, it might be argued that a short useful life would be proper on the theory that knowledge and technical skills become obsolete and therefore are short-lived.¹⁶¹ However, the factual and legal predicates for this argument are debatable. Standard capitalization doctrine, which holds that depreciation deductions on an asset used to acquire, create, or construct other assets is capitalized to such other assets,¹⁶² would appear to apply in this case, given that education is itself but one component of the more inclusive asset of human capital.¹⁶³ What counts is a person's capacity to combine knowledge with skills, motivation, and effort to generate wages. The process of acquiring and manipulating even obsolete knowledge renders subsequent learning, practice, and wage-earning easier, more efficient, and more useful.¹⁶⁴ The *content* of knowledge is possibly not even a component of human capital, because it is available in libraries.

given plaintiff suffered a loss of income-earning capacity indicates that the injury was "personal." *E.g.*, *Roemer v. Commissioner*, 716 F.2d 693 (9th Cir. 1983).

¹⁶⁰ Various characteristics of human capital are set forth in T.W. Schultz, *Education and Population Quality*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 11, 12. Although an entrepreneur derives return both from conventional capital investment and human-capital investment, the tax system does not usually have to segregate the two. *But cf.* § 162(a)(1) (corporations can deduct reasonable salary but not disguised return on investment capital) and I.R.C. § 911(a) (1988) (exclusion for foreign source "earned income" of a U.S. taxpayer; income from a business in which capital is a material income-producing factor is not "earned income").

¹⁶¹ Lebowitz, *supra* note 1, at 830 (analogizing educational expenses to start-up costs under I.R.C. § 195 (1988)).

¹⁶² I.R.C. § 263A(a)-(b) (Supp. III 1991); *Commissioner v. Idaho Power Co.*, 418 U.S. 1, 10-13 (1974).

¹⁶³ Depreciation of the separate components of human capital would not make any sense, because the components have no meaningful existence apart from the whole, and neither the components nor the whole can be alienated. *Cf.* Calvin Johnson, *Component Depreciation in the Purchase of Businesses*, 58 TAX NOTES 983, 985 (1993) (letter to the editor).

¹⁶⁴ Education paves the way for further education and training. *See Hinchliffe, supra* note 57, at 141, 143.

The proponents of accelerated amortization would have the burden of justifying it.¹⁶⁵ But invoking the "matching" concept of accounting is of no avail, because depreciation in taxation is keyed instead to "loss."¹⁶⁶ Nor does amortization follow from attempting to characterize educational outlays as an "investment." The student does not directly purchase the right to any future income stream.¹⁶⁷ The screening theory of (higher) education suggests a useful

¹⁶⁵ I do not concur with Professor Davenport's suggestion, see Davenport, *supra* note 9, at 406-08, that accelerated depreciation is proper where the future income stream is speculative. Depending on how the particular speculative investment plays out, the depreciation formula may misstate the net income in either direction. However, there is no a priori reason to favor a generous depreciation schedule. The currently accepted method of dealing with speculative intangible investments is under the income-forecast method, under which the depreciation is a function of current net income, and where the depreciation formula is subject to adjustment for significant changes in the expected future income stream, e.g., Rev. Rul. 89-62, 1989-1 C.B. 78. In theory, an *ex post* depreciation system, with interest adjustments to compensate for inaccuracies in the *ex ante* system, could be designed. In any event, investments in human capital are not particularly risky or speculative. A taxpayer's stock of human capital is not to be equated with a particular job, from which the taxpayer may be severed. The human capital is intact, and, short of death or disability (which are subject to actuarial calculation), it is capable of being exercised. Nor does the possibility that the taxpayer may decline to exercise her human capital lead to a contrary conclusion. Failure to exercise one's human capital, or being laid off, does not create a tax loss any more than does the occurrence of a vacancy in rental property or a self-inflicted casualty. See § 165(h)(4)(E); *Hort v. Commissioner*, 313 U.S. 28 (1941). Only passage-of-time losses generate depreciation deductions under a "realization" income tax.

¹⁶⁶ See Joseph M. Dodge, *Normative Depreciation Run into the Ground*, 54 TAX NOTES 1567, 1568 (1992) (letter to the editor).

¹⁶⁷ Thus, Professor Davenport's invocation of "Kahn depreciation," see Davenport I, *supra* note 1, at 889-904, is misguided. Briefly, Kahn depreciation is accelerated because—and contrary to the overwhelming weight of scholarly opinion—it would ignore the passage-of-time increase in value of future receipts as they arrive closer to realization. See Douglas A. Kahn, *Accelerated Depreciation—Tax Expenditure or a Proper Allowance for Measuring Net Income?*, 78 MICH. L. REV. 1 (1979). The Kahn model, at best, would only apply to financial investments, where it can plausibly be argued that the purchase price can be "allocated" to discrete future receipts. It can have no application to investment in human capital, because there is no purchase of any future receipts. See also Yishai Beer, *Toward Extension of the Option Tax Legislation: From Option 'In Personam' to Option 'In Rem'*, 58 TAX NOTES 1097 (1993) (viewing professional education as an option to make future investments). Mr. Beer then argues that the student should be able to amortize the series of options. However, Beer's analysis presupposes the ability to distinguish between the personal and investment components of education, *id.* at 1107, whereas my position is that such bifurcation is impossible both factually and conceptually. See *supra* text accompanying notes 128-31. Moreover, Beer's option model presupposes a corresponding income inclusion by the seller of the investment, but in the human-capital area such sellers are typically tax exempt entities. In the absence of the discipline that would be imposed by such inclusion, the concept of "cost" would have to be narrowly limited in order to preclude the

life equal to the person's remaining life expectancy, which is the useful life of credentials in general.¹⁶⁸ And, insofar as credentials are "signs" of underlying (positive) personality attributes, which are normally expected to improve with age, decelerated depreciation is indicated.¹⁶⁹ In fact, outside of a few professions, persons with high educational credentials enjoy substantial increases in earnings with age.

2. *Are Degrees Separate and Distinct Assets?*

Although the credentialist theory of educational investment might be cited in support of the contention that *degrees* are assets (like licences) separate from the person, degrees should be treated as human capital, because (1) degrees, although capable of being "bought," cannot be sold, and (2) the degree yields incremental income only in conjunction with the other components of human capital.¹⁷⁰

3. *Deductions for Employment-Related Expenses*

Present law currently allows employment-related deductions where (1) the outlay is considered an "expense," *and* the taxpayer is already engaged in the business of being an employee or (2) the outlay creates a depreciable or amortizable asset related to the taxpayer's business of being an employee.¹⁷¹ Deductions that relate to the earning of wages should not be categorically disallowed, as such a rule would place services businesses at a disadvantage compared to capital-intensive ones. However, outlays that involve the acquisition of human capital should not generate tax write-offs.¹⁷² Several borderline categories will now be examined.

marketing of human capital as a tax shelter. Finally, Beer fails to demonstrate that accurately measuring income from human capital along the lines suggested would be good policy.

¹⁶⁸ See *supra* note 22.

¹⁶⁹ See Gross, *supra* note 1, at 936-37.

¹⁷⁰ But cf. *Newark Morning Ledger Co. v. United States*, 113 S. Ct. 1670, 1681-83 (1993) (holding that a taxpayer could allocate part of the cost of acquiring newspapers to an amortizable intangible called "paid subscribers" apart from nonamortizable goodwill). Basis and capital recovery inhere in all business assets, but do not inhere in human capital, which is personal. Thus, isolating a component of human capital does not lead to amortization.

¹⁷¹ See Treas. Reg. § 1.162-5 (as amended in 1967); *Sharon v. Commissioner* 66 T.C. 515 (1976), *aff'd per curiam*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979); *Cremona v. Commissioner*, 58 T.C. 219 (1972), *acq.*, 1975-2 C.B. 1.

¹⁷² *Welch v. Helvering*, 290 U.S. 111 (1933); *Denman v. Commissioner*, 48 T.C. 439, 445 (1967), *acq.*, 1968-2 C.B. 2.

a. Professional Licences and Fees

Although taxpayers have succeeded in amortizing the bare cost of professional licences,¹⁷³ this result would seem to stand on no stronger a footing than amortization of degrees. The essential difference between human capital and business capital is that the former cannot be alienated and the latter can be.¹⁷⁴ This inalienability is inherent in human capital, and is not self-imposed by contract or otherwise for the purpose of tax avoidance.¹⁷⁵ According to this test, most professional licences such as bar admissions, medical specialty licences, CPA licences, and so on, would be treated as a nondeductible component of human capital.

Bar dues (for example), whether prepaid or paid annually, are distinguishable from licences, because the dues "purchase" various services provided to the legal profession and its members, including self-regulation. The fact that in some states the payment of bar dues is mandatory to maintain one's licence is not dispositive. Simply because it is expedient to "tax" attorneys on a universal basis to cope with the free-rider problem does not mean that bar dues purchase human capital.

b. Continuing Education

The regulations allow a deduction for educational costs where the education maintains or improves one's skills in an existing trade or business or to meet specific requests of an employer for additional education beyond the minimum required for employment.¹⁷⁶ These regulations are obviously modeled on the distinction between Improvements and repairs: Improvements (acquisition costs of human capital) are neither deductible nor amortizable, whereas repairs are currently-deductible business expenses.

The idea that repairs to assets are "expenses" is highly suspect¹⁷⁷ under the general principle that outlays that have value beyond the current period are

¹⁷³ *Sharon v. Commissioner*, 66 T.C. 515, 525-27 (1976), *aff'd per curiam*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979).

¹⁷⁴ *See Bateman v. United States*, 490 F.2d 549, 554-57 (9th Cir. 1973) (Wright, J., dissenting).

¹⁷⁵ Historically, taxpayers have argued that nontransferability of property precludes inclusion of the property in gross income. *See, e.g., United States v. Drescher*, 179 F.2d 863 (2d Cir.), *cert. denied*, 340 U.S. 821 (1950). This issue was essentially put to rest by the enactment of section 83 in 1969. Avoiding income by restrictions on transferability has too much tax-avoidance potential to be tolerated. Also, it results in the mismeasurement of income. *See supra* note 100 and accompanying text. Tax avoidance is not a problem with human capital; nonalienability cannot be avoided.

¹⁷⁶ Treas. Reg. § 1.162-5(c)(1) (as amended in 1967).

¹⁷⁷ *See Johnson, supra* note 153, at 1086-89.

capital expenditures.¹⁷⁸ Continuing education does not maintain existing knowledge and skills—it is not some kind of technique for enhancing recall—rather, it involves new knowledge; therefore, it would generally satisfy the basic capitalization principle; this is the case also with conventional repairs, like a paint job.

But what should the cost of continuing education be capitalized to? Most continuing education involves learning information that is available in published materials. In general, the cost of acquiring a library should be capitalized and amortized, although the regulations allow current expensing of the same by an individual on a *de minimis* basis.¹⁷⁹ Information that is generally available can be treated as being separate from human capital, and the cost of obtaining it should be treated accordingly.

One might distinguish (1) education that involves intensive skill training, (2) education that one must obtain in order to acquire or maintain one's occupational status, and (3) education that involves a potential change in occupation, because it is plausible to treat these categories as being allocable to human capital. However, making distinctions of this sort may not be worth the effort. An easy-to-administer test would be to disallow the cost of all degree programs; this test would achieve the desired results in most cases.

c. Job-Seeking and Moving Outlays

Under present caselaw, job-seeking outlays are deductible if the job being sought falls within the “same” trade or business as the taxpayer's current employment, on the basis of an analysis that is essentially the same as that involved in connection with continuing education courses.¹⁸⁰ Moving “expenses” are currently deductible under § 217,¹⁸¹ provided only that certain conditions relating to full-time employment at the new locale are met and that the move is not within the same narrow geographical area.¹⁸²

An economist would say that both job-seeking and moving (“migration”) outlays are human capital acquisition costs.¹⁸³ However, the tax law need not go so far. The fact that these outlays relate to the future does establish that they

¹⁷⁸ *INDOPCO v. Commissioner*, 112 S. Ct. 1039, 1044–45 (1992).

¹⁷⁹ *Treas. Reg.* § 1.162-6 (1958) (professionals). Otherwise, the first \$10,000 of investment in tangible business assets can be expensed. *See I.R.C.* § 179 (Supp. III 1991), *amended by* 107 Stat. 312, 432 (1993).

¹⁸⁰ *Cremona v. Commissioner*, 58 T.C. 219 (1972), *acq.*, 1975-1 C.B. 1; *see also* *Rev. Rul.* 78-93, 1978-1 C.B. 38.

¹⁸¹ *See* section 217(b), which defines moving expenses to include costs of moving the taxpayer, the taxpayer's family, and personal effects to the new residence.

¹⁸² *See* § 217(a), (c). The taxpayer need not have previously been employed, and the new job need not be in the same line of work as the old job.

¹⁸³ *See* BECKER, *supra* note 10, at 39–40; Woodhall, *supra* note 10, at 24.

are capital expenditures, but are they to be capitalized to "human capital" in the tax sense (wage-earning capacity of the person) or to some intangible asset apart from the person, such as the job itself? A particular employment does not necessarily increase the income-producing capacity of the *person*, nor does it embody a life-style choice in the same way that choosing a profession does; the job only allows the taxpayer's human capital to be deployed at a specified time and place and in a certain manner.¹⁸⁴ Although the employee cannot usually sell the job, upon leaving the job, the latter typically reverts to the labor market. Thus, although the issue presents a close call, one could reasonably conclude that a particular employment position is more like an *alienable* licence than like human capital.¹⁸⁵

Following the job-as-asset approach, the cost of a *successful* job search would be a conventional business capital expenditure. The result should not hinge on whether the new job is in the taxpayer's same line of business as the old job, or even whether it is the taxpayer's first job.

A technical problem would be to determine the useful life of the asset in question, that is, the job, because it cannot be predicted in any given case how long it will be held. An asset without an ascertainable useful life cannot be amortized, even if it is known that the asset does not have an infinite useful life.¹⁸⁶ It would not be unreasonable to amortize the costs over the remaining period until expected retirement (age 65 or 70), while allowing a loss equal to the unamortized basis in case the job is prematurely lost.¹⁸⁷ On the other hand, it can be argued that the unamortized costs of the old job should be recapitalized to any new job acquired, on the theory that obtaining any given job is typically a function (in part) of previous positions held. Perhaps a legislative compromise solution is called for here.¹⁸⁸

Although some moves are undoubtedly job-related, many are undoubtedly motivated by lifestyle choices. Although, in theory, moving expenses that are incidental to obtaining a job could be capitalized to the job, in practice it would often be difficult to determine whether the move or the job was "primary." Another problem is that the useful lives of moving costs and job-seeking costs can differ: A series of jobs may be obtained in the new location; likewise, a given job may persist through several moves. The foregoing suggests that

¹⁸⁴ See *Primuth v. Commissioner*, 54 T.C. 374, 381 (1970), *acq. in result*, 1972-2 C.B. 2.

¹⁸⁵ Cf. *Commissioner v. Ferrer*, 304 F.2d 125 (2d Cir. 1962) (holding that the surrender of movie rights back to the copyright holder who re-assigned the rights to a third party is treated as a "sale").

¹⁸⁶ See Treas. Reg. § 1.167(a)-3 (as amended in 1960) (citing goodwill).

¹⁸⁷ Cf. Treas. Reg. § 15a.453-1(c)(3) (1981) (in installment sale with contingent selling price, amortize basis of sold property over maximum period over which payments can be received).

¹⁸⁸ Cf. § 195 (five-year amortization of business start-up costs).

moving costs should be eligible for current or future write-off, as job-seeking expenses, only if (1) the taxpayer continues to be employed by the same employer or (2) the new job yields a significant (say, five percent) salary increase relative to the former job or both.¹⁸⁹

The case of costs of an *unsuccessful* job search raises issues similar to those raised by dry holes in oil and gas exploration and research costs that lead up blind alleys: Should they be written off as current expenses or losses or be capitalized to whatever future job (if any) might eventually be obtained?¹⁹⁰ Because of the small amounts involved, I would propose an easy-to-administer rule, such as to deduct the cost currently unless either a job is obtained within a year, or the search is for one's first (full-time) job,¹⁹¹ in which case the cost should be capitalized and written off as described above.

d. Summary

My proposals with respect to educational, job-seeking, and moving expenses would render obsolete the troublesome issue under current law as to whether the education or the sought-after job was in the "same" business that the taxpayer had been carrying on. Because that inquiry cannot be managed in a just and coherent fashion,¹⁹² it should be abolished. The suggested approach would also avoid having to decide whether the underlying motive for changing jobs was "business" or "personal" (such as a desire to live in a warmer climate

¹⁸⁹ Cf. I.R.C. § 132(a)(6), (g) (qualified moving expense reimbursement is an excludable fringe benefit), added by § 13213(d)(2) of the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312. With the addition of this section, I.R.C. § 217 (Supp. IV 1992) should be repealed. See also U.S. DEP'T OF TREAS., BLUEPRINTS FOR TAX REFORM, at 55 (1977) (moving expenses are "personal").

¹⁹⁰ See DONALD E. KIESO & JERRY J. WEYGANDT, INTERMEDIATE ACCOUNTING 543-44 (4th ed. 1983); Frank M. Burke, *Current Expensing of Geological and Geophysical Costs: A Need for Legislative Clarification*, 34 OKLA. L. REV. 778, 786-87 (1981); ACCOUNTING FOR RESEARCH AND DEVELOPMENT COSTS, Statement of Financial Accounting Standards No. 2, ¶ 12 (Fin. Accounting Standards Bd. 1974). The capitalized costs could be deducted as a loss when the search is abandoned. Cf. Rev. Rul. 83-105, 1983-2 C.B. 51 (geological and geophysical outlays).

¹⁹¹ If a person was unemployed for at least a year or a student in a degree program, any job sought would be deemed to be a "first" job for purposes of this rule.

¹⁹² According to the leading case in this area, *Sharon v. Commissioner*, 66 T.C. 515 (1976), *aff'd per curiam*, 591 F.2d 1273 (9th Cir. 1978), *cert. denied*, 442 U.S. 941 (1979), the test is whether "different tasks and activities" are involved. *Id.* at 528. The case was actually decided, however, on the basis of state licensing requirements. See *id.* at 528-30. The latter test is easier to administer, but it favors business executives, who are all in the business of being "managers," over professionals such as lawyers, doctors, nurses, and accountants, who are subject to different licensing categories by various jurisdictions.

or near family). The new job still produces wage income,¹⁹³ and the related costs would be written off against the new income stream.

Notwithstanding the fact that job-seeking and moving outlays might be distinguished from human capital, perhaps the technical problems in designing a suitable writeoff for them should give one pause. Job-seeking and moving outlays are closely analogous to human capital outlays, and the seeking of one's first job (and moving to it) following higher education can be viewed as an extension of the higher education itself. Moreover, the task of weeding out lifestyle-motivated job searches and moves might well be intractable. Perhaps decisively, because the presence or absence of any writeoff for job-seeking and moving expenses is unlikely to affect behavior—whether because the job seeking or moving is “personal,” “involuntary” (to terminate unemployment), or to seek increased wages—optimal taxation theory suggests not allowing any writeoffs here. Although one is tempted to offer a narrow writeoff for the job-seeking and moving outlays of the laid-off or chronically unemployed on ability-to-pay grounds, the better approach is probably direct subsidy by way of unemployment compensation, job-training programs, and employee reimbursements to name a few.

This mode of analysis has potential application to other issues involving employee work-related outlays, such as work clothing, tools, and the development and maintenance of physical attributes. The first step in the analysis would be to determine whether the outlay relates to (1) property of the taxpayer, (2) the taxpayer's human capital (including her profession or line of work), or (3) a particular job. The second step would be to determine whether the outlay is a capital expenditure or an expense. The third step would be to evaluate any possible writeoff in terms of fairness, economic policy, and tax administration.

III. WOULD AMORTIZATION OF HIGHER-EDUCATION COSTS BE GOOD POLICY?

As the foregoing indicates, I would emphatically reject the position that a tax provision that satisfies the Haig-Simons definition of income is somehow exempt from general policy scrutiny, whether one calls it “tax expenditure analysis” or something else.¹⁹⁴ No special expertise is required to grasp the point that the amortization proposal fails under an overall policy perspective.

¹⁹³ There should be a requirement, as under current section 217(c)(2), that full-time work be obtained.

¹⁹⁴ See *supra* note 8; see also Crane, *supra* note 77, at 86–90 (analyzing scholarship exclusion both in terms of income definition and as tax expenditure); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an “Ideal” Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831 (1979); McNulty, *supra*

A. Revenue Effects

Under current budgetary law, revenue-losing bills are out of bounds unless equal revenue raisers are included.¹⁹⁵ The amortization proposal is a clear loser. In the 1990–91 academic year, total tuition and fees of institutions of higher education exceeded \$30 billion.¹⁹⁶ If one subtracts scholarships and grants of about \$12 billion,¹⁹⁷ that leaves an \$18 billion net. The annual revenue loss would depend on the amortization schedule, but eventually (assuming a weighted average marginal tax rate of 30% against which the amortization deductions are taken), the annual revenue loss will eventually reach \$6 billion a year, ignoring future tuition increases, tax rate increases, student population increases (if any), and inflation.¹⁹⁸

The argument might be made that the net revenue loss is overestimated, because (1) more graduates will earn more money and (2) positive externalities will be generated that will improve the economy as a whole. However, “positive externality” is a utility concept that does not necessarily translate into increased income of taxpayers. Also, equal or greater income or positive externalities or both may be created by alternative uses of the revenue involved.

It cannot even be assumed that greater aggregate wage income will be generated. Initially, going to college and professional school usually entails unemployment or underemployment, and this phenomenon would create an immediate additional revenue loss. Furthermore, if amortization induces more people to pursue higher education, wages of educated persons might be depressed by oversupply¹⁹⁹ or by a perceived dilution in the value of the

note 2 (tuition payments generally are the same). See generally Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661, 1662–63 (1992); Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165 (1993).

¹⁹⁵ See Budget Enforcement Act of 1990, § 252(b), 2 U.S.C. § 902(b) (Supp. III 1991).

¹⁹⁶ CHRON. OF HIGHER EDUC., *supra* note 47, at 35. This \$30 billion figure is arrived at by rough extrapolation from the 1987–88 figure of \$27.9 billion. The 1985–86 figure was \$23 billion.

¹⁹⁷ *Id.* at 11 (counting federal, state, and institutional grants). These figures are for 1990–91.

¹⁹⁸ If the costs are amortized over 14 years, it will be 15 years before the annual amortization deductions equal annual net tuition and fees, as new amortizers enter the work force each year.

¹⁹⁹ It is likely that low salaries for academics in the liberal arts is partly a function of supply and demand. L.C. Solmon, *The Range of Educational Benefits*, in ECONOMICS OF EDUCATION, *supra* note 10, at 83, 90. Given that the demand for education is somewhat responsive to expectations of future earnings, see FREEMAN, *supra* note 11, at 208–09, 223–

credentials.²⁰⁰ In addition or in the alternative, wages of uneducated persons might be pushed down further because the latter are perceived to lack minimum credentials and be undesirable.²⁰¹ In other words, the fact that education creates wage differentiation does not logically lead to a result of greater aggregate wage income.

The revenue loss could be contained by some cap on the costs eligible for write-off.²⁰² A plausible option might be to allow only annual costs to be eligible for future write-off up to a fixed dollar figure (say, \$5,000 per year) selected to approximate the annual average resident tuition in public institutions of higher learning—the theory being that any excess over the cap is deemed to be “consumption” attributable to personal or family taste.²⁰³ Some might object, however, to shortchanging private education, which is the one area where market forces have some play, if imperfectly.

B. Goals of the Tax Expenditure

In terms of policy, the goal of a tax benefit for higher education costs must be either or both of (1) making it cheaper for persons to obtain higher education (subsidy effect) or (2) inducing more people to obtain higher education (incentive effect). Either way, a tax benefit in the form of an amortization deduction makes no sense.

1. Subsidy Effect

The case for offering a subsidy to students presupposes that education is overpriced. This supposition is flatly contradicted by the human-capital hypothesis (including the “screening” theory) and the fact that higher education is heavily subsidized by government and charitable largess,²⁰⁴ because tuition revenues account for only about a third of higher education expenditures.²⁰⁵

24, it is probable that the demand for liberal arts education has declined in the last 30 years relative to natural and hard social sciences.

²⁰⁰ See Robert H. Seidman, *The Logic and Behavioural Principles of Educational Systems: Social Independence or Dependence?*, in *THE SOCIOLOGY OF EDUCATIONAL EXPANSION*, *supra* note 25, at 267–92; Thurow, *supra* note 22, at 373–418.

²⁰¹ See Olneck & Kim, *supra* note 23, at 193–94, 205 (focusing on high school dropouts).

²⁰² Argrett, *supra* note 1, at 657.

²⁰³ The literature is sparse on the relation, if any, between institutional prestige and incomes. Again, there would be a causation problem, because success-motivated persons may be more likely to attend the Yales and Stanfords than less prestigious institutions.

²⁰⁴ In 1990–91, tuition and fees averaged \$1,809 at four-year public institutions and \$9,391 at private institutions. See *CHRON. OF HIGHER EDUC.*, *supra* note 47, at 35. In 1988, about 10.2 million students attended public institutions of higher education, and 2.9 million

Using tax-base write-offs to provide subsidies is perverse: The value of the subsidy is directly proportional to the taxpayer's highest marginal rate brackets in the amortization years.²⁰⁶ In addition, the subsidy is collected well after the costs are incurred. If the amortization period is substantial (for example, forty-five years), or a ceiling is imposed on eligible costs, the tax savings will be inconsequential both on a per-year basis and a present-value basis,²⁰⁷ especially if the amortizable amount is not indexed for inflation.

An alternative justification for a subsidy is that the good or service is a "necessity" that deserving people "can't afford." Calling higher education a necessity is an exercise in political rhetoric, not a policy argument.²⁰⁸

2. Incentive Effect

No government benefit to students would be expected to operate as an incentive to obtain higher education unless there is elasticity between obtaining higher education and immediately entering the labor market. For most middle- and upper-class children, higher education is the ascribed choice, especially when existing subsidies are factored in, because they can both have their cake (education) and eat it too (obtain parental support or borrow money cheaply, and perhaps enjoy considerable leisure as well).²⁰⁹ An incentive should be directed at the margin, which in this case means members of the lower class,²¹⁰ who not only are prone not to obtain higher education for cultural or affordability reasons or both,²¹¹ but also generally tend to think that college

students attended private institutions. 2 OFFICE OF EDUC. RESEARCH AND IMPROVEMENT, U.S. DEP'T EDUC., *THE CONDITION OF EDUCATION* 215 (1991).

²⁰⁵ THOMAS G. MORTENSON, *WHY STUDENT FINANCIAL AID?* 1 (ACT Student Financial Aid Research Report Series No. 87-1, 1987).

²⁰⁶ Assuming taxpayers in the 15% and 39.5% rate brackets respectively, a deduction of \$1,000 saves \$150 for the former and \$395 for the latter.

²⁰⁷ The present value, at a 10% discount rate compounded annually, of a \$22,500 deduction spread out over 45 years, assuming a 30% tax rate, is only \$1,479. This amount cannot be realized in advance, because it is not a property or contract right.

²⁰⁸ I.R.C. § 135 (Supp. III 1991), allowing exclusion of interest on U.S. savings bonds if the proceeds are used for education, is irrational policy-wise, because, if the basic idea is sound, there is no reason to limit the investment to U.S. savings bonds.

²⁰⁹ There is some correlation between rising tuition and lower student enrollment, particularly for two-year colleges. See MORTENSON, *supra* note 205, at 9-10.

²¹⁰ Because identifying the margin as the lower class is a crude generalization, any incentive tailored solely to the lower classes is bound to be inefficient.

²¹¹ The gap in college attendance between the highest and lowest family income quartiles has increased significantly since 1980. See THOMAS G. MORTENSON, *THE REALLOCATION OF FINANCIAL AID FROM POOR TO MIDDLE INCOME AND AFFLUENT STUDENTS 1978 TO 1990* at i (ACT Student Financial Aid Research Report Series No. 90-2,

education is not worth the cost.²¹² But it would be wholly implausible to hypothesize that an amortization deduction against future wage income would provide a meaningful incentive at the margin for persons with low incomes. As mentioned above, the present value of future amortization deductions would be virtually zero.²¹³ The would-be student, needing support now, would not be able to obtain any current cash from the future tax benefit. Even a current deduction would have little value: Most students would be near or below the threshold of taxability.²¹⁴ Any tax deduction would favor those who will find themselves in higher income tax brackets in the future, but future income is not likely to correlate with present need on any systematic basis.²¹⁵

The potential incentive effect of an amortization deduction might possibly be stronger in the case of graduate and professional schools, which are not usually considered necessities, so that parental support would likely be reduced. On the other hand, part-time work is often either tolerated or built into the education itself, through teaching and research assistantships and internships. But the basic problems remain: The incentive is a deferred economic benefit of small value that cannot be presently realized, and the effect of the incentive is perverse.

C. Price Effects

It is axiomatic that a portion of any subsidy will be captured by the provider of the subsidized goods and services, especially where the supply

1990). Not surprisingly, sensitivity to price changes appears to increase as family income decreases. *See* MORTENSON, *supra* note 205, at 9–10.

²¹² A Gallup poll found that only 27% of those from families with incomes below \$20,000 thought that college was a sound investment, whereas 60% of those from families with income above \$50,000 thought so. MORTENSON, *supra* note 64, at 33.

²¹³ *See supra* note 207. A more effective subsidy would be to allow interest on educational loans to be deductible.

²¹⁴ Gifts, support, scholarships, and loan proceeds are all excluded from gross income. §§ 102(a) (gifts and bequests), 117(a) (qualified scholarships); *Gould v. Gould*, 245 U.S. 151 (1917) (support); *see, e.g., Commissioner v. Tufts*, 461 U.S. 300 (1983) (concerning loan proceeds). Some students would obtain the standard deduction of slightly more than \$2,500, \$3,000, \$4,400, or \$5,000, as indexed for inflation, depending on filing status. *See* § 63(c). However, the deduction is lost, except to the extent of the greater of \$500 or “earned income,” if the student is being claimed as a dependency exemption by another taxpayer. § 63(c)(5). The student may claim a personal exemption of slightly more than \$2,000, unless the student is being claimed as a dependency exemption by another taxpayer. § 151(a), (d)(2).

²¹⁵ Wage income, on an aggregate basis, is at least partially a function of genes, family upbringing, and social milieu. *See supra* notes 14–18. Students who must work have less time available to study and to socialize.

curve is relatively inelastic²¹⁶—which is typically the chief condition that gives rise to the demand for a subsidy in the first place.²¹⁷ Educators are not incapable of appropriating additional educational resources for their own direct or indirect benefit.²¹⁸ Tuitions, at least at private institutions, have risen at a faster rate than inflation over the last fifteen years.²¹⁹ As a professor, I would welcome additional subsidies to education and students; as a parent I might think twice.

D. Welfare Effects

The case for a tax expenditure for higher education in any form must ultimately make out the case that more college, vocational, graduate, and professional education is not just good for the students' lifestyles but also that the benefits to society as a whole justify yet another government intervention.²²⁰ The public benefits of education are sometimes vaguely denoted by such terms as "positive externalities" and "international economic competitiveness." Indeed, public support for this education has traditionally been marshaled along these lines,²²¹ although notions of "equality of opportunity" and "minimal equipment for citizenship in a democracy" have

²¹⁶ In laymen's terms, demand increases for a relatively fixed supply.

²¹⁷ The submarket of education constituted by high-prestige, private boarding institutions is quite inelastic, because institutional reputations change slowly, if at all.

²¹⁸ Solmon, *supra* note 199, at 84; see CARNEGIE COUNCIL ON POLICY STUDIES IN HIGHER EDUCATION, *GIVING YOUTH A BETTER CHANCE* 175-77 (1979) [hereinafter *GIVING YOUTH A BETTER CHANCE*]. From 1952-1970, faculty compensation increased in absolute terms, and from 1970-1978 did not fare badly. Moreover, academic compensation is surprisingly high considering market factors. See HOWARD BOWEN, *THE COSTS OF HIGHER EDUCATION* 48-75 (1980). Affluent institutions devote a relatively higher percentage of their resources to administration and other nonacademic staff. *Id.* at 19-23, 150. Of course, increased expenditures per student might increase the quality of education at a particular institution, but this result is not assured. *Id.* at 152-68. In any event, expenditures per student do not correlate with increased earnings. James et al., *supra* note 24, at 250-51.

²¹⁹ See Elson, *supra* note 64, at 54 (indicating that this trend is likely to persist for the foreseeable future). For an argument that increasing costs are largely a function of government regulation, see Margaret S. Gordon & Charlotte Alhadeff, *Instructional Costs and Productivity, 1930-1977*, in *THREE THOUSAND FUTURES* 319 (Carnegie Council Policy Studies in Higher Educ. 1980). See also Michael S. McPherson et al., *Recent Trends in U.S. Higher Education Costs and Prices: The Role of Government Funding*, 79 AM. ECON. REV. 253, 255 (1989) (noting that elite private colleges devote a large portion of incremental funding to scholarship programs and capital outlays, apparently to compete with other like institutions for the best students).

²²⁰ See, e.g., Solmon, *supra* note 199, at 84.

²²¹ See W.W. McMahon, *Externalities in Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 133, 133 (listing possible positive externalities without quantifying them).

also been prominent.²²² However, the literature has not adequately quantified the net positive externalities, especially for higher education, and without this quantification policy discussion is severely hampered.

It is not enough to establish that more higher education is a good thing. One must also ask whether the public spending on higher education is the best use of scarce resources to improve aggregate social welfare (however defined).²²³ Also, the particular means of aiding higher education, that is, through tax write-offs that provide benefits keyed to the highest marginal rate brackets of individuals, must be preferable to other available means.²²⁴ Finally, one must ask whether all kinds of higher education are equally deserving of government aid.

1. *Do We Need More Professional and Graduate Education?*

The fact that professional education is widely perceived as offering a direct and adequate return on educational investment is itself a compelling argument against additional government across-the-board assistance to students.²²⁵ The human-capital literature shows that the private rate of return declines at progressively higher educational levels; in fact, negative rates of return exist for certain graduate studies.²²⁶ These statistics are weak circumstantial evidence that graduate and professional education does not provide sufficient social benefits so as to justify increased government aid. More to the point, the assumption that the U.S. needs more doctors, lawyers, and even scientists has recently come under attack.²²⁷ This critique is given added force when one

²²² See generally JOHN DEWEY, *DEMOCRACY AND EDUCATION: AN INTRODUCTION TO THE PHILOSOPHY OF EDUCATION* (1916).

²²³ See, e.g., H.M. Levin, *School Finance*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 426-28.

²²⁴ See M. Woodhall, *Cost-Effectiveness Analysis in Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 348, 348.

²²⁵ See *supra* note 42 (discussing Texas tuition rates).

²²⁶ See *supra* note 24. Social status, on the other hand, appears to increase disproportionately to ever-higher income educational levels. COLEMAN ET AL., *supra* note 50, at 68-78.

²²⁷ As to the legal profession, see STEPHEN P. MAGEE ET AL., *BLACK HOLE TARIFFS AND ENDOGENOUS POLICY THEORY* 111-21 (1989); KEVIN M. MURPHY ET AL., *THE ALLOCATION OF TALENT: IMPLICATIONS FOR GROWTH* (National Bureau of Economic Research Working Paper No. 3530, 1990), *reprinted in* 106 Q.J. ECON. 503 (1991) (both arguing that the disproportionate number of lawyers in the U.S. may have a significant negative effect on economic growth). *But see* Frank B. Cross, *The First Thing We Do, Let's Kill All the Economists: An Empirical Evaluation of the Effect of Lawyers on the United States Economy and Political System*, 70 TEX. L. REV. 645 (1992). As to the health care profession, see RICHARD D. LAMM, *THE BRAVE NEW WORLD OF HEALTH CARE* 5-6 (May 1990); 1 COUNCIL ON GRADUATE MEDICAL EDUC., U.S. DEP'T OF HEALTH AND HUMAN

considers that professions are adept at creating demand for their services and the services of other professions.²²⁸ In addition, increased specialization in professions commands a disproportionate amount of economic resources.²²⁹

It is no answer to say that we need more *good* lawyers or doctors, because no single occupation should have a monopoly on talent and skills. Arguments by lawyers to the effect that society is (or would be) better off because people have (or should have) various substantive "rights" are problematical and self-serving.²³⁰ Similarly, arguments by the elderly and health-care providers that people are entitled to unlimited amounts of medical care would, if heeded, likely bankrupt the economy and the federal fisc.²³¹

The market in graduate education does not appear to be subject to the normal law of supply and demand, as the supply of Ph.D.s far exceeds the demand for full-time tenure-track instructors, especially in the liberal arts.²³²

SERVICES, FIRST REPORT OF THE COUNCIL 13-14 (1988). As to scientists, see Boyce Rensberger, *Scientist Shortfall a Myth*, WASH. POST, April 9, 1992, at A1.

²²⁸ See Richard H. Sander & E. Douglass Williams, *Why Are There So Many Lawyers? Perspectives on a Turbulent Market*, 14 LAW & SOC. INQUIRY 431, 471-73 (1989). Lawyers create demand for legal services by creating pervasive and complex regulatory schemes and rules that promote litigation, all of which puts pressure on other professions to increase the level of the services they provide. Tax, securities, corporate, and regulatory laws create vast demand for accountants. Family, labor, and criminal law creates a need for incremental criminal justice personnel, mental health professionals, and alternate dispute resolution professionals. Tort and environmental law impact upon the health care and engineering professions. Technological and financial innovations require new and more complex legal regimes. See, e.g., *Symposium-New Financial Products, the Modern Process of Financial Innovation, and the Law*, 69:6 TEX. L. REV. vii; see also *supra* note 35.

²²⁹ See Mwangi Kimenyi, *Rent-Seeking in the Academy: The Political Economy of Specialty Programs*, ACADEMIC QUESTIONS, Spring 1992, at 41; Julie Kosterlitz, *Wanted: GPs*, NAT'L J., Sept. 5, 1992, at 2011.

²³⁰ Briefly, individual rights can conflict with each other or the social good or both, needlessly complicating (or even stalemating) policy-making. See, e.g., T. Alexander Aleinikoff, *Constitutional Law in the Age of Balancing*, 96 YALE L.J. 943, 946-47 (1987).

²³¹ See MARK J. WARSHAWSKY, BD. OF GOVERNORS OF THE FED. RESERVE SYS., PROJECTIONS OF HEALTH CARE EXPENDITURES AS A SHARE OF GNP: ACTUARIAL AND ECONOMIC APPROACHES 1-4 (1991) (estimating that health care costs will constitute between 30% and 50% of the GNP by the year 2065); Sally T. Sonnefeld et al., *Projections of National Health Expenditures Through the Year 2000*, 13 HEALTH CARE FINANCING REV. 1, 13 (1991) (estimating that health care expenditures will take up 24.1% of the federal budget by the year 2000). Unlike consumer goods or even wealth, which are subject to the "law" of declining marginal utility, there is no inherent limit on the demand of individuals to be kept alive and in good health as long as possible. See generally Symposium, *The Law and Policy of Health Care Rationing: Models and Accountability*, 140 U. PA. L. REV. 1505 (1992).

²³² See *supra* notes 31-32.

An amortization deduction for graduate students could only aggravate this situation, which is in the self-interest of universities to maintain.²³³

My point is only that we cannot simply *assume* that we need more professionals and graduate students. In addition, it is doubtful that the complex problems pertaining to various professions can be appreciably solved by a "program" of indiscriminate assistance to all students in higher education in the form of an amortization deduction.

2. *Is There a Shortage of College Graduates?*

The U.S. has by far the highest percentage of college enrollment of any major developed country, about twice the level of Western Europe.²³⁴ In fact, about 400,000 foreign students obtain higher education in the U.S. each year.²³⁵ Because the standard of living in the U.S. is losing ground relative to many other advanced economies,²³⁶ three possible hypotheses suggest themselves: (1) the huge investment in college education does not in fact give the U.S. a substantial competitive advantage, (2) an educational advantage might exist, but it is outweighed by other negative inputs, and (3) college education largely compensates for inadequate education at lower levels. None of these hypotheses implies the allocation of yet more public resources to college education.²³⁷

²³³ Graduate students provide a cheap source of teachers and research assistants, and the oversupply of Ph.D.s creates a situation of intense job competition that yields high productivity, often in nontenure track low-paying positions. But what is good for universities is not necessarily good for the rest of society, as intellectual resources are diverted from other productive uses.

²³⁴ N.L. Hicks, *Education and Economic Growth*, in ECONOMICS OF EDUCATION, *supra* note 10, at 101, 102.

²³⁵ Jill Smolowe, *The Pursuit of Excellence*, TIME, Apr. 13, 1992, at 59.

²³⁶ STAFF OF JOINT COMM. ON TAXATION, 92D CONG., 1ST SESS., FACTORS AFFECTING THE INTERNATIONAL COMPETITIVENESS OF THE UNITED STATES 3, 16, 17 (Comm. Print 1991).

²³⁷ The resources should be allocated to lower educational levels or other areas (applied technology, industrial organization, aggregate savings, on-the-job training) where the U.S. might be at a comparative disadvantage. *See, e.g.*, JOB TRAINING PARTNERSHIP ACT ADVISORY COMM. TO THE U.S. SEC'Y OF LABOR, U.S. DEP'T OF LABOR, WORKING CAPITAL: COORDINATED HUMAN INVESTMENT DIRECTIONS FOR THE 90's 11-13 (Mar. 1989) (analyzing literacy and drop-out prevention); GIVING YOUTH A BETTER CHANCE, *supra* note 218, at 185-98. Mark Blaug & John Mace, *Recurrent Education—The New Jerusalem*, in EDUCATION OF AN ECONOMIST, *supra* note 10, at 143 (noting recurrent education, as a substitute for full-time postsecondary schooling, refers to modules of education provided from time to time, throughout life, during interrupted periods of full-time employment).

Although it appears that employment over the last fifty years has shifted towards more-educated and higher-paying occupations,²³⁸ this point bears on the private—as opposed to public—desirability of expanded higher education. From the point of view of economic development, the literature stresses investment in primary education and on-the-job training.²³⁹ Similarly, most of the positive externalities attributed to education (lower crime rates, lower dependence on welfare, better health, more efficient markets, democratic values), by their nature, show diminishing marginal returns with incremental levels of education.²⁴⁰ Indeed, too much education entails negative externalities: An over-educated work force tends to have low morale, resulting in an actual loss of productivity.²⁴¹

According to the screening theory, higher education is overrated as a contributor to productivity and growth;²⁴² it mainly selects out those individuals who will be trained by employers and offered the opportunity to move up the career ladder.²⁴³ The screening hypothesis suggests that more of the financial burden of higher education should be borne by private industry rather than the public.²⁴⁴ Moreover, insofar as desirable employee traits are a function of the personal maturation process, higher education performs

²³⁸ Kevin M. Murphy & Finis Welch, *Occupational Change and the Demand for Skill, 1940–1990*, 83 AM. ECON. REV. 122, 122 (1993).

²³⁹ P. Foster, *The Contribution of Education to Development*, in ECONOMICS OF EDUCATION, *supra* note 10, at 93, 100; see Hicks, *supra* note 234, at 101, 103, 106; STAFF OF JOINT COMM. ON TAXATION, *supra* note 236, at 55 (noting reluctance of firms to bear cost of job training where work force is highly mobile).

²⁴⁰ See Robert W. Hartman, *The Rationale for Federal Support for Higher Education*, in DOES COLLEGE MATTER? SOME EVIDENCE OF THE IMPACTS OF HIGHER EDUCATION 271, 278–85 (Lewis C. Solmon & Paul J. Taubman eds., 1973). Some positive externalities of higher education are social tolerance, slightly higher propensity to save, more efficient spending on consumption, and greater attention to childrearing (especially education!). See Charlotte Alhadeff & Margaret S. Gordon, *Higher Education and Human Performance*, in THREE THOUSAND FUTURES, *supra* note 219, 219–39.

²⁴¹ See RUSSELL W. RUMBERGER, OVEREDUCATION IN THE U.S. LABOR MARKET 101–16 (1981); Val Burris, *The Social and Political Consequences of Overeducation*, 48 AM. SOC. REV. 454 (1983); H.M. Levin, *Work and Education*, in ECONOMICS OF EDUCATION, *supra* note 10, at 147, 152–53.

²⁴² Mark Blaug, *Where Are We Now in the Economics of Education?*, in EDUCATION OF AN ECONOMIST, *supra* note 10, at 129.

²⁴³ See *supra* text accompanying notes 21–27.

²⁴⁴ See Rudolph G. Penner, *Economic Growth*, in CHALLENGE TO LEADERSHIP 67, 86 (Isabel V. Sawhill ed., 1988).

noneducational functions (such as "parking" and socialization), for which cheaper and more efficient substitutes could be devised.²⁴⁵

The fact that advances in standard of living are largely a function of technology suggests that any additional government subsidies for education be concentrated in the natural sciences and engineering.²⁴⁶ On the other hand, and despite common wisdom to the contrary, evidence exists to the effect that there really is no shortage of scientists and engineers in the United States.²⁴⁷ In any event, it would be awkward to discriminate by way of the tax system in favor of particular academic disciplines.²⁴⁸ Nonfavored disciplines would explicitly be labeled, by the terms of a law of general applicability, as second-class.

Nor is it certain that increased public investment in education will result in an increased aggregate private investment return. At certain times and places, there appears to have been too much higher education,²⁴⁹ in which case the value of a college degree as a credential was diluted by oversupply, resulting in a narrowing of the gap between the starting wages of college and high school graduates.²⁵⁰ Although some might favor the narrowing of income disparities, oversubsidizing higher education is a bizarre technique of achieving it. At other times (such as the present), the gap widens,²⁵¹ which in itself may be undesirable, not to mention the fact that aggregate wages fail to rise due to the decline in the wages of the noneducated.²⁵²

²⁴⁵ The armed services perform similar functions for a predominately low income clientele. This analysis leaves out of account the issue of the social value of research performed by university faculties and the appropriate blend of teaching and research.

²⁴⁶ See Becker, *supra* note 10, at 351.

²⁴⁷ See SCHEETZ, *supra* note 42, at vii (providing that demand for sciences and engineering graduates among college recruiters was comparable to other areas, although bachelors degrees in certain engineering fields and computer science command highest starting salaries); Rensberger, *supra* note 227.

²⁴⁸ Discrimination already exists under I.R.C. section 174 (Supp. III 1991), where "research" is limited to scientific and technological research, not to research in the humanities and social sciences. Treas. Reg. § 1.174-2(a)(1) (1987).

²⁴⁹ See CAROLINE BIRD, *THE CASE AGAINST COLLEGE* 116-35 (1975); Richard B. Freeman, *Overinvestment in College Training?*, 10 J. HUM. RESOURCES 287 (1975).

²⁵⁰ The gap narrowed in the 1970s but widened again in the 1980s, perhaps due to (1) greater need for computer literacy and (2) a declining manufacturing sector attributable to trade imbalances. Lawrence F. Katz & Kevin M. Murphy, *Changes in Relative Wages, 1963-1987: Supply and Demand Factors*, 107 Q.J. ECON. 35, 35-37 (1992).

²⁵¹ See *id.* For another overview of trends, see Margaret S. Gordon & Charlotte Alhadeff, *The Labor Market and Higher Education*, in *THREE THOUSAND FUTURES*, *supra* note 219, at 176.

²⁵² See John Bound & George Johnson, *Changes in the Structure of Wages in the 1980's: An Evaluation of Alternative Explanations*, 82 AM. ECON. REV. 371, 389 (1992) (suggesting a shortage of college graduates in the 1980s); Hicks, *supra* note 234, at 101, 103.

Increased higher education, therefore, does not necessarily translate into a narrowing of the gap between the rich and the poor or equality of opportunity.²⁵³ Government educational subsidies, especially at the state and local level, operate regressively overall benefiting the well-off at the expense of the poor,²⁵⁴ and even need-based scholarship aid may have the effect of subsidizing the middle class while being insufficient to attract the lower classes.²⁵⁵ The shift during the 1980s from grant programs to loan programs has widened the gap between the well-off and the poor with respect to the utilization of higher education.²⁵⁶

In addition to the human capital hypothesis, there already exist ample pressures to increase the availability of higher education. Since the early 1970s, advances in technology have eliminated the need for much unskilled and semi-skilled labor, resulting in a split of the labor market into primary and secondary segments: In the former, firms will train employees to move up the ladder; in the latter both wages and career-advancement opportunities are low.²⁵⁷ During times when the supply of sufficiently-educated entrants into the job market exceeds the number of new slots in the primary segment, an aspiring worker faces the choice of being permanently under-employed or else of having to obtain still more educational credentials.²⁵⁸ Thus, the screening function of education appears to create a dynamic that requires more and more layers of it in order to function properly.²⁵⁹

The same dynamic operates on the social level. Higher education for the masses drives the (future) elite to differentiate themselves by obtaining high-prestige college degrees²⁶⁰ and graduate or professional degrees.²⁶¹ The middle

²⁵³ See JENCKS, *supra* note 18, at 7-8 (noting, *inter alia*, that education alone has little impact on the percentage of the population below the poverty level).

²⁵⁴ This issue is reviewed in Mark Blaug, *The Distributional Effects of Higher Education Subsidies*, 2 ECON. EDUC. REV. 209 (1982), reprinted in EDUCATION OF AN ECONOMIST, *supra* note 10, at 204.

²⁵⁵ See W. Lee Hansen, *Impact of Student Financial Aid on Access*, in THE CRISIS IN HIGHER EDUCATION 84, 91-96 (Joseph Froomkin ed., 1983).

²⁵⁶ See MORTENSON, *supra* note 64, at i.

²⁵⁷ The literature is summarized in N. Bosanquet, *Internal Labour Markets and Education*, in ECONOMICS OF EDUCATION, *supra* note 10, at 164-66.

²⁵⁸ J-P. Jallade, *Youth Unemployment and Education*, in ECONOMICS OF EDUCATION, *supra* note 10, at 166, 169.

²⁵⁹ If all entrants into the labor market were to have high school diplomas, then the diplomas would be worthless as credentials: some further credential would be needed to sort them out. See Seidman, *supra* note 200, at 267, 285-86.

²⁶⁰ Parental willingness to pay significantly higher fees for private education can be explained in terms of social stratification. The very fact that something is more expensive often renders it more desirable. See Daniel Levy, *The Rise of Private Universities in Latin America and the United States*, in THE SOCIOLOGY OF EDUCATIONAL EXPANSION, *supra* note 25, at 107-15. At the same time, the concept of "elite" may vary among institutions.

class views higher education as the ticket to upward mobility, demanding more of it,²⁶² but the elite can always stay one step ahead.²⁶³

Institutional factors also contribute to the expansion of higher education.²⁶⁴ Public higher education follows the "law" of bureaucratic growth.²⁶⁵ Heavy subsidies even to private institutions, combined with the market and non-market returns, render higher education an irresistible bargain. Expansion is limited only by the reluctance of legislators to raise taxes or tuition or both, and nervousness by administrators over the possibility of setting prices in excess of what the traffic will bear.²⁶⁶ Additional government aid *through a tax write-off* would only feed the higher-educational Leviathan without extracting a significant social benefit in return.

3. *Do We Need More Vocational Education?*

The whole project of institutional vocational education is subject to criticism in that it fails to inculcate transferable skills and adaptability to further training. It is not surprising, therefore, that traditional institutional vocational education generates a very low private rate of return.²⁶⁷ Thus, it is a dubious candidate for heavy public investment of a generic sort, although vocational education aimed at drop-outs and welfare recipients might have value. However, a tax write-off aimed at this group would be pointless in the extreme.

Private colleges in high demand with high tuitions and large endowments may seek (and be able to afford) to breed an elite of intellectual meritocracy (as opposed to a pure social class). Nevertheless, it appears that there is a trend among elite private colleges to consider ability to pay in granting admissions. The result is a higher proportion of students from families with incomes above \$100,000. Mary Jordan, *'Need-Blind' Admissions Policy at Top Private Colleges Losing Favor to Wealth*, WASH. POST, Apr. 26, 1992, at A1.

²⁶¹ See B.R. Chiswick & C.U. Chiswick, *Income Distribution and Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 255, 260.

²⁶² See B.C. Sanyal, *Graduate Unemployment and Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 172, 175.

²⁶³ See Benoit Millot, *Educational Poilatch as a Mode of Social Regulation in France*, in *THE SOCIOLOGY OF EDUCATIONAL EXPANSION*, *supra* note 25, at 205, 208-09 (noting that various factors prevent widespread education from generating widespread social equality).

²⁶⁴ For a general discussion of the growth in higher education, see generally *THE SOCIOLOGY OF EDUCATIONAL EXPANSION*, *supra* note 25.

²⁶⁵ See generally William J. Bennett, *Our Greedy Colleges*, N.Y. TIMES, Feb. 18, 1987, at A31; see also McPherson et al., *supra* note 219, at 254 (noting different responses in differing segments of the market).

²⁶⁶ Reduced or static governmental support can in some cases be more than made up for by increased private support. See also *supra* note 42.

²⁶⁷ RANDALL COLLINS, *THE CREDENTIAL SOCIETY* 16-17 (1979); GIVING YOUTH A BETTER CHANCE, *supra* note 218, at 137.

Most "real" vocational education consists of in-house skill and job training.²⁶⁸ Employers know their own needs much better than do academic institutions.²⁶⁹ From this perspective, formal vocational education seems mostly superfluous.²⁷⁰ If any government interventions are in order, they should be directed at private employers, not students.²⁷¹ In fact, at least two tax expenditure programs already exist of this type, the targeted-jobs credit²⁷² and the exclusion for employer-provided education.²⁷³

4. *What Do We Need?*

What the educational system probably needs most is more and earlier education at the bottom²⁷⁴ and better education in the middle.²⁷⁵ With respect to international economic competitiveness, greater resources should be devoted to job training in the private sector.²⁷⁶ It has been repeatedly shown that the

²⁶⁸ See LESTER C. THUROW, DANGEROUS CURRENTS 173-215 (1983) (stating that on-the-job training is the primary mode of acquiring human capital). See generally EMPLOYMENT & UNEMPLOYMENT IN EUROPE 35 (Jean-Pierre Jallade ed., 1981).

²⁶⁹ See C. Benson, *The Planning of Vocational Education*, in ECONOMICS OF EDUCATION, *supra* note 10, at 323, 323-24.

²⁷⁰ But cf. BECKER, *supra* note 10, at 20-27 (making a distinction between "general," i.e., transferable skills, which an employee would pay for in a rational market, and "specific" skills of use only to the particular employer).

²⁷¹ See generally GIVING YOUTH A BETTER CHANCE, *supra* note 218, at 94, 95, 107-52, 230-44.

²⁷² I.R.C. § 51 (Supp. III 1991), amended by 107 Stat. 312, 420, 556; I.R.C. § 52 (Supp. III 1991).

²⁷³ I.R.C. § 127 (Supp. III 1991), amended by 107 Stat. 312, 420; see also § 117(c) (for employees of educational institutions only).

²⁷⁴ There is virtually unanimous support that early education is the most cost-effective way to prevent failure, meaning illiteracy, dropping out of school, and failure to obtain minimum skills. See, e.g., RESEARCH AND POLICY COMM., COMM. FOR ECONOMIC DEV., INVESTING IN AMERICA'S FUTURE 21 (1988).

²⁷⁵ See generally EDUCATION REFORM IN THE '90s (Chester E. Finn & Theodor Rebarber eds., 1992) (focusing on school administration); GIVING YOUTH A BETTER CHANCE, *supra* note 218, at 177, 208-09 (1979) (recommending increased federal funding for secondary schools, but not mentioning tax benefits); David Card & Alan B. Krueger, *Does School Quality Matter? Returns to Education and the Characteristics of Public Schools in the United States*, 100 J. POL. ECON. 1 (1992) (stating that quality of public schools, as measured by such factors as student-teacher ratios and teacher salaries, positively correlates with lifetime earnings). One study opines that the U.S. spends less than most other industrial nations on primary and secondary education. EDITH M. RASELL & LAWRENCE MISHSEL, SHORTCHANGING EDUCATION (Economic Policy Inst. Briefing Paper, 1990).

²⁷⁶ See DAVID OSBORNE, ECONOMIC POL'Y INST., ECONOMIC COMPETITIVENESS: THE STATES TAKE THE LEAD 62-65 (1987); Michael L. Wachter, *The Training Component of Growth Policies*, in REMOVING OBSTACLES TO ECONOMIC GROWTH 41, 59 (Michael L.

greatest private and social rate of return inures to primary education.²⁷⁷ Also, the primary and secondary school system needs to be made more efficient, so that basic literacy and problem-solving skills can be imparted at a reasonably early age.²⁷⁸ Over the last thirty years, expenditures per pupil have tripled, while performance has stagnated.²⁷⁹ Young people should not have to merely "serve time" in school when they could be experimenting with careers. Primary and secondary schools should be less rigid with respect to promotions and ages; students should be able to "drop out," as in college. None of these—or other—reform possibilities suggest a tax write-off for students of higher education.²⁸⁰

Ultimately, advocates of greater investment in human capital must accommodate themselves to the claimed need for greater investment in business capital and high technology.²⁸¹ A tax break pertaining to higher education would be expected to come to some degree at the expense of conventional investment. The government does not have unlimited resources to parcel out.

E. Distributional Effects

An amortization deduction would primarily benefit the upper classes, who value and use education and who are mostly itemizers.²⁸² This bias would be aggravated if the amortizable cost included amounts received by gift and bequest but not by scholarship. Moreover, the benefit would be a windfall largely for behavior that would have been undertaken without the tax break.

Wachter & Susan M. Wachter eds., 1984). See generally GIVING YOUTH A BETTER CHANCE, *supra* note 218, at 107–52; M. Woodhall, *Financing Vocational and Industrial Education*, in ECONOMICS OF EDUCATION, *supra* note 10, at 439, 442.

²⁷⁷ See *supra* note 240.

²⁷⁸ A survey of college recruiters lists the following as employer needs least well served by college education: written and oral communications skills, decisionmaking skills, attitude toward the work ethic, judgment skills, and maturity. Technical expertise and general business skills are well down the list. SCHEETZ, *supra* note 42, at 41.

²⁷⁹ See John E. Chubb & Erik A. Hanushek, *Reforming Educational Reform*, in SETTING NATIONAL PRIORITIES: POLICY FOR THE NINETIES 213, 217 (Henry J. Aaron ed., 1990).

²⁸⁰ Cf. *Courses of Action*, in THREE THOUSAND FUTURES, *supra* note 219, 118, at 125–27 (discussing optimal role of federal government in improving higher education, without mentioning tax breaks for students and parents).

²⁸¹ Isenbergh, *supra* note 153, at 284–86.

²⁸² See *supra* note 212.

IV. CONCLUSION

The amortization of higher education outlays is not compelled by tax theory, whether it be neutrality, Haig-Simons income, horizontal equity, or ability-to-pay. If anything, analysis of both theory and principles rejects amortization of student educational costs.

The amortization proposal suffers from all of the usual procedural defects of tax expenditures: The goal is not clearly defined; the means do not conform to any reasonable ends; in terms of revenue, allocative efficiency, social welfare, and distributional effects, the costs are ignored and the benefits simply assumed to exist; alternative uses of government funds are not examined; and no mechanism is offered to monitor the tax expenditure program once in place. An examination of the merits also indicates that student write-offs of tuition costs would be an extremely poor kind of tax expenditure.

If aid to students attending university is politically necessary, the basic choice is between direct aid based on need and making educational loans freely available. Adequate need-based aid could improve equality of opportunity and social mobility. On the other hand, it might attract free riders who have no real ambition. Loans would be seen as a means of rationalizing the market in education, because loans are not usually made available on the "security" of future wages. It would make sense for a student to borrow money if the rate of return on the education exceeded the loan interest rate.²⁸³ However, students may not calculate costs and benefits in a rational fashion. With no "real" security, loans may be viewed as free money. Given the likelihood of frequent default, it would be hard to design a student loan program without a substantial subsidy element.²⁸⁴

The problem of social human-capital investment, if any, lies far deeper than the tax system's influence on the allocation of material resources. The problem lies in the quality of education and parenting, especially at the pre-college level, not an inadequate quantity of higher education. If there is social underinvestment in certain types of education, it would be desirable to target the government intervention as narrowly as possible. A generic tax break for students obtaining higher education would divert social resources to the well-off without any gains in either the educational system or society at large.

Analysis of the amortization proposal has also exposed the poverty of much tax policy analysis carried on by legal academics, particularly the dogmatic

²⁸³ See J. Wiseman, *Public Finance in Education*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 436, 438. See generally M. Woodhall, *Student Loans*, in *ECONOMICS OF EDUCATION*, *supra* note 10, at 445.

²⁸⁴ It has been estimated that current government loan programs contain a subsidy component (in the social aggregate) of 25-55% of the amount lent. See BARRY P. BOSWORTH ET AL., *BROOKINGS INST., THE ECONOMICS OF FEDERAL CREDIT PROGRAMS* 132-35 (1987).

reliance on such concepts as Haig-Simons income, neutrality, and personal consumption. On the positive side, freedom from the constraints imposed by these concepts should open up fruitful opportunities to explore one of the more fundamental issues pertaining to the income tax base, namely, what should be deducted under the rubric of "business or investment."